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Vol 3366
3366

No. 19,866

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

BERNARD D. FLAXMAN,

Appellant,

vs.

GEORGE GARDNER, Trustee in Bankruptcy for Pride Furniture Manufacturing Ltd.,

Appellee.

PETITION FOR REHEARING.

See also Vol. 3343

FLAXMAN, COLEMAN, GORMAN & ROSOFF,
By MARTIN S. FRIEDLANDER,
416 West Eighth Street,
Los Angeles, Calif. 90014,
Attorneys for Appellant.

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No. 19,866

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Appellee.

PETITION FOR REHEARING.

To the Honorable Stanley N. Barnes, Frederick J. Hamley and Gilbert H. Jertberg, Circuit Court Judges:

Comes now Bernard D. Flaxman, Appellant above named, and respectfully petitions the Court for rehearing of its judgment entered in the above matter on November 19, 1965 for the following reasons:

1. That in its decision of November 19, 1965, this Court, in part, held that the propriety of a superseded Assignee's disbursements is to be determined by the benefit resulting from said disbursements to the ensuing bankrupt estate. That the holding herein enumerated has a public importance which transcends the controversy between Appellant and Appellee. That said holding threatens the general assignment for the benefit of creditors as a liquidating device in the sense that it imposes a hindsight test upon an Assignee.

2. That there is presently pending before this Court the undocketed case of *Bass v. Quittner, Stutman & Treister,* a case involving the identical point of law enumerated in paragraph 1 hereof. That Appellant was unaware of the pendency of that case until subsequent to the rendition of this Court's decision on November 19, 1965. That Appellant has since studied the memoranda filed in the District Court in the *Bass v. Quittner, Stutman & Treister* matter, said District Court having reached a conclusion on the point of law enumerated in paragraph 1 hereof contrary to that of this Court. That the memoranda, filed as aforesaid in the District Court, raise certain important issues which were not presented to this Court in the briefs and oral argument. That the point of law enumerated in paragraph 1 hereof is of substantial public interest, as previously noted, and is of a highly technical nature. That Appellant believes that this Court may well be persuaded to revise its judgment of November 19, 1965 upon considering the issues and arguments raised in *Bass v. Quittner, Stutman & Treister.*

3. We believe that a portion of this decision should be clarified as it may mislead the courts below, for it does not clearly present what test is to be applied as to the propriety of the expenses and fees of an assignee for the benefit of creditors.

It is our impression that the Court properly applied § 2(a)(21) of the Bankruptcy Act, and held that the fees and expenses of an assignee may only be surcharged if they are either "improper or excessive". Then the Court stated on page 4 of its opinion that: "It was sensible for the referee to conclude that if a particular service, ordered by the assignee, was of no benefit to the

estate of the bankrupt, it would be "improper" within "the meaning of section 2(a)(21), . . ." Furthermore, the court seems to state on page 5 of its opinion that the further test as to propriety is whether the trustee would have found it necessary to use said services involved.

It is this writer's interpretation that the Court has held that if the trustee would have found it necessary to use said services involved, there would be a benefit to the estate, and therefore the assignee's pre-bankruptcy fees and disbursements would be proper under §2(a)-(21). Other bankruptcy practitioners interpret this opinion to mean that the referee has to make two determinations as to whether the disbursements have been proper. The first being whether or not there has been a benefit to the estate, the second being whether the trustee would have found it necessary to use said services involved. Since there has been much confusion among the bankruptcy practitioners as to the correct interpretation of this Court's holding, we pray that the Court grant our petition for rehearing so that the Court may clarify its opinion.

Wherefore, Appellant prays that this Court vacate its judgment of November 19, 1965 and grant rehearing in this matter concurrently with its hearing of *Bass v. Quittner, Stutman & Treister.*

Respectfully submitted,

FLAXMAN, COLEMAN, GORMAN & ROSOFF,
By MARTIN S. FRIEDLANDER,
Attorneys for Appellant.

Certificate.

I certify that in my judgment this Petition for Rehearing is well founded and is not interposed for delay.

MARTIN S. FRIEDLANDER

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 19868

FILED
AUG 9 1966
WM. B. LUCK, CLERK

QUINAULT TRIBE OF INDIANS, et al., Appellants,

v.

A. M. GALLAGHER, et al., Appellees.

APPELLANTS' REPLY TO APPELLEES' SUPPLEMENTAL BRIEF

On May 31, 1966, appellees filed an unauthorized supplemental brief, raising for the first time the argument that the disclaimer in the Washington constitution was a nullity under the equal-footing doctrine.[1] Our motion to strike was denied, but leave to reply to appellees' argument was granted, and accordingly this reply is hereby submitted.

Appellees' argument is unsound. It is true that provisions of an enabling act, even though incorporated in a state constitution, are not binding on the state if they purport to

1. Appellees had leave to file a response to the Justice Department's amicus brief, but not to argue a new theory.

deprive the state of jurisdiction over matters over which the states would normally be expected to assert jurisdiction.[2/] But as appellees' own quotations show (pp. 3, 4, 6-7), the equal-footing doctrine does not invalidate restrictions imposed on the state by Congress with respect to a matter over which Congress has paramount jurisdiction, such as Indian affairs. A leading case is United States v. Sandoval, 231 U.S. 28 (1913), where Congress required New Mexico, as a condition to becoming a state, to prohibit introduction of liquor into Indian country. This prohibition in the enabling act was upheld. To similar effect, see also Dick v. United States, 208 U.S. 340 (1908); Ex parte Webb, 225 U.S. 663 (1912).

Consequently, Congress had clear power to require Washington to agree to the disclaimer as a condition to admission, and we would not have understood appellees to suggest otherwise, except for some language at the end of their brief (p.8), that the inclusion of the disclaimer in the constitution was merely

> "... an expression that Washington recognizes the constitutional authority of the Congress over the Indians and Indian reservations when it [Congress?] decides to exercise this jurisdiction."

2. For instance, in Coyle v. Smith, 221 U.S. 559 (1911) the Oklahoma enabling act required the state to agree irrevocably that the state capital would be located at Guthrie and relocated before 1913, and the state did irrevocably agree. Nevertheless, the capital was moved in 1910. The Court approved, on the ground that this was "essentially and peculiarly state business." At p.565.

If this is to suggest that the disclaimer is not an affirmative restraint on the state from invading the federal area of Indian affairs, we would disagree.[3/] One of appellees' quotations suggests (p.4, bottom) that the disclaimer gains its force solely from Congress's exclusive jurisdiction over Indian affairs, rather than from its acceptance by the state. But another quotation cited by appellees (p.7, top) suggests that the state might properly agree to forego taxation of Indians, and further, that such an agreement raises no equal-footing question.

After reviewing the equal-footing cases, appellees conclude (p.8) that

> "... when the Congress sees fit to relinquish its exclusive jurisdiction, it is relinquished to Washington as well as to any other state, the provisions of the Enabling Act notwithstanding."

We are unable to follow this reasoning. Congress in Public Law 280 did not relinquish jurisdiction to Washington; it relinquished jurisdiction to five named states (not including Washington) and no others. It offered to relinquish jurisdiction to the other states on certain conditions, and one of them so far as Washington is concerned is that Washington repeal its constitutional disclaimer. Congress in enacting Public Law 280 could

3. See Dept. of Interior, Federal Indian Law (1958) at p. 503: "One of the most preclusive reasons [for the incapacity of the states to legislate on Indian affairs] is found in the express disclaimers of state jurisdiction over Indian lands stipulated in Enabling Acts and incorporated in State constitutions". This authoritative source certainly assumed that the disclaimers were affirmative restraints.

have said, "You states who have constitutional disclaimers, originally adopted at our insistence, may regard them as cancelled, so far as we are concerned. You may repeal the disclaimer, or not, as you please." But Congress did not say that; instead, it said: "You states who have constitutional disclaimers will have to amend your constitutions before you can take jurisdiction over Indians." Consider once more the language of Section 6 of Public Law 280:

> "Provided, That the provisions of this Act shall not become effective with respect to such assumption of jurisdiction by any such State until the people thereof have appropriately amended their State constitution or statutes as the case may be."

This was an express condition precedent, and until complied with, jurisdiction could not shift to the state.

The great amount of briefing this case has received tends to obscure the fact that it presents no more than a simple matter of offer and acceptance, and has little or nothing to do with federal supremacy, exclusive federal jurisdiction over Indians, state's rights, equal-footing, or any other complicated theory. Congress chose to relinquish jurisdiction to Washington only if it amended its constitution. The condition not having been met, Washington has not accepted Congress's offer. The case is that simple.

Respectfully submitted,



Charles A. Hobbs
Attorney for Appellants
1616 H Street, N.W.
Washington, D.C. 20006

WILKINSON, CRAGUN & BARKER
Jerry C. Straus

LESOURD & PATTEN

Gladys Phillips
Of Counsel

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing reply brief is in full compliance with those rules.

Charles A. Hobbs

CERTIFICATE OF SERVICE

Served this _____ day of August, 1966, by mailing one copy each to the attorneys for appellees: Jane Dowdle Smith, Assistant Attorney General, Temple of Justice, Olympia, Washington, and L. Edward Brown, Esquire, Prosecuting Attorney for Gray's Harbor County, P.O. Box 529, Montesano, Washington.

Charles A. Hobbs

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 19868

QUINAULT TRIBE OF INDIANS, et al., Appellants,

v.

A. M. GALLAGHER, et al., Appellees.

PETITION FOR REHEARING

On September 19, 1966, this Court affirmed a decision of the United States District Court for the Western District of Washington dismissing our action for a declaratory judgment and injunctive relief. Expressly refraining from reaching the merits of the controversy, the Court agreed with our assertion that federal questions were presented by our case which "could invoke federal question jurisdiction under 28 U.S.C. 1331" (Slip Op. p. 6). However, the Court ruled that the District Court lacked jurisdiction to hear the cause because "the matter here in controversy does not exceed the sum or value of $10,000" (Slip Op. p. 8).[1/]

1. The Court also ruled that there was no jurisdiction under the Civil Rights Act, 42 U.S.C. 1983, 28 U.S.C. 1343(3).

We seek rehearing on the grounds that it is no longer required that our case involve $10,000. On October 10, 1966, the President signed a bill into law[2] which provides that:

> "The district courts shall have original jurisdiction of all civil actions, brought by any Indian tribe or band with a governing body duly recognized by the Secretary of the Interior, wherein the matter in controversy arises under the Constitution, laws, or treaties of the United States."

The effect of this legislation is to give the district courts federal question jurisdiction in cases brought by Indian tribes irrespective of amount in controversy.[3]

We respectfully request this Court to vacate its previous opinion and proceed to a determination of the merits of the case. As of October 10, 1966, the federal district court had jurisdiction to entertain our suit since, as previously determined by this Court the suit presents questions arising "under the Constitution, laws, or treaties of the United States." The only other prerequisite to jurisdiction under the provisions of S. 1356 is that the action be brought by an Indian tribe "with a

2. S. 1356, copy attached. This bill is now Public Law 89-635. The President's action is reported in 112 Cong. Rec. D987 (daily edition October 11, 1966).

3. See S. Rept. 1507, copy attached.

governing body duly recognized by the Secretary of Interior." While our complaint does not specifically allege this fact, it is undisputed that the Quinault Tribe has a governing body so recognized.[4/] This Court may allow amendment of the complaint to so reflect that jurisdictional fact.[5/]

It can well be argued that S. 1356 was intended by Congress to validate pending cases wherein the $10,000 requirement was not met. The language of the statute says that the district courts "shall have jurisdiction" if the conditions specified (federal question and suit brought by a governing body of a tribe) are met. Absent language providing that the Act is to have no effect on pending cases, the effect of the language quoted is to confer immediate jurisdiction. When Congress has intended to exclude pending cases from the effect of new jurisdictional rules, it has said so expressly. Thus, when, in 1958, the jurisdictional amount in federal question and diversity suits was increased from $3,000 to $10,000 (Public Law 85-554, 72 Stat. 415), the statute stated:

4. See attached letter from Department of Interior.

5. See Texaco-Cities Service Pipe Line Co. v. Aetna Casualty and Surety Company, 283 F.2d 144 (8th Cir. 1960); 28 U.S.C. 1653.

"This Act shall apply only in the case of actions commenced after the date of the enactment of this Act."

Forcing the Tribe to begin all over again in the District Court would serve no legitimate purpose. The District Court ruled against us from the bench, on the merits, as well as on jurisdictional grounds, after argument on the State's motion to dismiss the complaint, stating that the questions posed for decision were "better decided by an appellate court" and that "the best interests of the Quinaults and the State of Washington and all concerned will be advanced by prompt decision which will enable early review on a brief and inexpensive record".[6/] If a new suit were brought, there is no reason to suppose that the District Court would change its opinion. Appellants would be forced to take another appeal and the case would come before this Court in exactly the same posture as it is now.

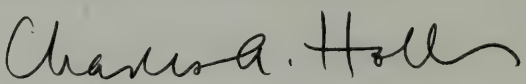
All that would be accomplished by such a procedure would be needlessly to subject the Tribe to furthur expense and delay. It would seem that Congress would not

6. See appellants' main brief, p. 11.

have intended such a result, in view of the remedial purposes of the legislation. Each day that this litigation is prolonged postpones the day when federal and state law enforcement officials will at last know what their respective responsibilities are. At present the status is in limbo, a highly unsatisfactory condition to all sides. The question of who has jurisdiction over the Quinault Reservation has been in dispute and litigation since 1957. This Court will serve the cause of justice and the interests of all sides by a decision on the merits at this time.

Respectfully submitted,

WILKINSON, CRAGUN & BARKER



By: Charles A. Hobbs

WILKINSON, CRAGUN & BARKER
Jerry C. Straus

LESOURD & PATTEN

Gladys Phillips
Of Counsel

CERTIFICATE

I certify that the foregoing petition for rehearing is well-founded, in my judgment, and is not interposed for purposes of delay.

Charles A. Hobbs

CERTIFICATE OF SERVICE

Served this 14th day of October, 1966, by mailing one copy each to the attorneys for appellees: Jane Dowdle Smith, Assistant Attorney General, Temple of Justice, Olympia, Washington, and L. Edward Brown, Esquire, Prosecuting Attorney for Gray's Harbor County, P.O. Box 529, Montesano, Washington.

Charles A. Hobbs

89TH CONGRESS
2D SESSION

S. 1356

IN THE HOUSE OF REPRESENTATIVES

AUGUST 29, 1966
Referred to the Committee on the Judiciary

AN ACT

To amend the Judicial Code to permit Indian tribes to maintain civil actions in Federal district courts without regard to the $10,000 limitation, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That title 28, United States Code, is hereby amended by inserting in chapter 85 thereof immediately after section 1361, a new section to be designated section 1362, as follows:

"§ 1362. Indian tribes

"The district courts shall have original jurisdiction of all civil actions, brought by any Indian tribe or band with a governing body duly recognized by the Secretary of the In-

terior, wherein the matter in controversy arises under the Constitution, laws, or treaties of the United States."

SEC. 2. The chapter analysis of chapter 85 of title 28 of the United States Code is amended by adding at the end thereof the following new item:

"1362. Indian tribes."

Passed the Senate August 26 (legislative day, August 25), 1966.

Attest: EMERY L. FRAZIER,

Secretary.

EPARTMENT OF TRANSPORTATION

nferees, in executive session, agreed to file a confer-ce report on the differences between the Senate- and ouse-passed versions of H.R. 15963, to create at the abinet level a Department of Transportation.

NANCIAL INSTITUTIONS

nferees, in executive session, agreed to file a confer-ce report on the differences between the Senate- and ouse-passed versions of S. 3158, strengthening the gulatory and supervisory authority of Federal agencies er insured banks and savings and loan associations.

C. POLICEMEN, FIREMEN, AND TEACHERS

nferees, in executive session, agreed to file a confer-ce report on the differences between the Senate- and ouse-passed versions of H.R. 15857, increasing salaries policemen, firemen, and teachers in the D.C.

PPROPRIATIONS—LABOR-HEW

nferees met in executive session to resolve the differ-ces between the Senate- and House-passed versions H.R. 14745, fiscal 1967 appropriations for the Depart-nts of Labor and Health, Education, and Welfare, d related agencies, but did not reach final agreement, d recessed subject to call.

VERTY

nferees continued in executive session to resolve the fferences between the Senate- and House-passed ver-ns of H.R. 15111, proposed Economic Opportunity t Amendments of 1966, but did not reach final agree-nt, and will meet again tomorrow.

ATER POLLUTION CONTROL

nferees continued in executive session to resolve the fferences between the Senate- and House-passed ver-ns of S. 2947, to improve and make more effective ograms under the Federal Water Pollution Control t, but did not reach final agreement and will meet ain on Thursday, October 13.

BILLS SIGNED BY THE PRESIDENT

New Laws

(*For last listing of public laws see* DIGEST, *p. D957, October 5, 1966*)

S. 2393, authorizing additional GS–16, GS–17, and S–18 positions for new agencies and expanded func-ns. Signed October 8, 1966 (P.L. 89–632).

H.R. 15510, relating to the payment of installments on ns insured by the Farmers Home Administration. gned October 8, 1966 (P.L. 89–633).

agency to carry out provisions of the Beirut Agreement for Facilitating the International Circulation of Visual and Auditory Materials of an Educational, Scientific, and Cultural Character. Signed October 8, 1966 (P.L. 89–634).

S. 1356, permitting Indian tribes to maintain civil actions in Federal district courts without regard to the $10,000 limitation. Signed October 10, 1966 (P.L. 89–635).

H.R. 14019, authorizing additional appropriations for the acquisition or construction of buildings for the Foreign Service. Signed October 10, 1966 (P.L. 89–636).

S.J. Res. 197, to extend until April 30, 1967, authority for Postmaster General to enter into leases of real property for periods not exceeding 30 years. Signed October 10, 1966 (P.L. 89–637).

S. 2070, providing for the holding of terms of the District Court for the District of South Dakota at Rapid City. Signed October 10, 1966 (P.L. 89–638).

H.R. 16608, to amend the charter of Southeastern University of the D.C. Signed October 10, 1966 (P.L. 89–639).

S. 2540, authorizing conclusion of an agreement for joint construction by U.S. and Mexico of flood control project for the Tijuana River. Signed October 10, 1966 (P.L. 89–640).

COMMITTEE MEETINGS FOR WEDNESDAY, OCTOBER 12

(*All meetings are open unless otherwise designated*)

Senate

Committee on Appropriations, Subcommittee on Defense Appropriations to meet in executive session jointly with the Committee on Armed Services for the consideration of reprograming requests, 10:30 a.m., 1224 New Senate Office Building.

Committee on the Judiciary, subcommittee, on the nomination of James E. Noland, to be U.S. district judge for the southern district of Indiana, 10:30 a.m., 2228 New Senate Office Building.

House

Committee on Agriculture, Subcommittee on Domestic Marketing and Consumer Relations, to consider H.R. 15959, to eliminate certain requirements under the Agricultural Adjustment Act with respect to effectuating marketing orders for cherries, 10 a.m., 1301 Longworth House Office Building.

Subcommittee on Forests, executive, on pending legislation, 9:30 a.m., 1302 Longworth House Office Building.

Committee on Education and Labor, General Subcommittee on Labor, to continue consideration of H.R. 16831, to investigate the effect of foreign competition on domestic employment when a complaint is filed by an employer or labor organization; and H.R. 17248, the Fair Labor Standards Foreign Trade Act, 9:30 a.m., 2257 Rayburn House Office Building.

Special Subcommittee on Education, executive, to continue the study of the Office of Education, 10 a.m., 2261 Rayburn House Office Building.

Calendar No. 1473

89TH CONGRESS 2d Session | SENATE | REPORT No. 1507

PERMITTING INDIAN TRIBES TO MAINTAIN CIVIL ACTIONS IN FEDERAL DISTRICT COURTS WITHOUT REGARD TO $10,000 LIMITATION

AUGUST 24, 1966.—Ordered to be printed

Mr. BURDICK, from the Committee on the Judiciary, submitted the following

REPORT

[To accompany S. 1356]

The Committee on the Judiciary, to which was referred the bill (S. 1356) to amend title 28, United States Code, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

AMENDMENTS

1. Page 1, line 4, strike "1360" and insert in lieu thereof "1361".
2. Page 1, line 5, strike "1361" and insert in lieu thereof "1362".
3. Page 1, line 6, strike "1361" and insert in lieu thereof "1362".
4. Page 1, after line 11, insert a new section 2:

SEC. 2. The Chapter Analysis of Chapter 85 of title 28 of the United States Code is amended by adding at the end thereof the following new item:

"§ 1362. Indian tribes."

PURPOSE OF AMENDMENTS

The previous section number assigned, 1361, is already in use, and the proposed section must be renumbered as 1362.

Purpose of Bill

The purpose of the bill as amended is to permit Indian tribes to bring civil actions arising under the Constitution, treaties, and laws of the United States, without regard to the $10,000 limitation, and accordingly amends chapter 85, title 28, United States Code, by adding a new section.

Statement

The Department of the Interior and the Judicial Conference of the United States have recommended that this bill pass. The Department of Justice declines to take a position on the bill, observing that it is a matter of policy upon which it is not appropriate for the Department to take a position. The Department of Justice points out, however, that there is no reason to believe that the number of cases which might result from the expansion of jurisdiction would be very large.

At hearings on this bill held by the Subcommittee on Improvements in Judicial Machinery, Senator Quentin N. Burdick, author of the bill, testified in its behalf. The Senator's statement was substantially confirmed by Mr. Richmond Allen, Associate Solicitor in charge of indian affairs for the Department of the Interior, and by Marvin Sonosky, Esq., an attorney speaking on behalf of some half-dozen Indian tribes. In substance, the proponents of this bill indicate that the jurisdictional limitation works an especial hardship on Indian tribes. In many instances claims arise under special treaties between the United States and the tribes, but because of the limitation the matter cannot be litigated in Federal courts. As an example, several parcels of land may be claimed by the tribes, each of the parcels being valued at under $10,000, even though the aggregate constitutes more than $10,000. However, these claims may not be added together for the purpose of meeting the jurisdictional amount, and the tribes are denied a Federal forum.

There is great hesitancy on the part of tribes to use State courts. This reluctance is founded partially on the traditional fear that tribes have had of the States in which their reservations are situated. Additionally, the Federal courts have more expertise in deciding questions involving treaties with the Federal Government, as well as interpreting the relevant body of Federal law that has developed over the years.

Currently, the right of the Attorney General of the United States to bring civil actions on behalf of tribes without regard to jurisdictional amount, a power conferred on him by special statutes, is insufficient in those cases wherein the interest of the Federal Government as guardian of the Indian tribes and as Federal sovereign conflict, in which case the Attorney General will decline to bring the action.

The proposed legislation will remedy these defects by making it possible for the Indian tribes to seek redress using their own resources and attorneys.

After a study of all of the foregoing the committee is of the opinion that this legislation is meritorious, and recommends that the bill S. 1356, as amended, be considered favorably.

Department of the Interior, the Department of Justice, and the Judicial Conference of the United States.

U.S. DEPARTMENT OF THE INTERIOR,
OFFICE OF THE SECRETARY,
Washington, D.C., December 22, 1965.

Hon. JAMES O. EASTLAND,
Chairman, Committee on the Judiciary,
U.S. Senate, Washington, D.C.

DEAR SENATOR EASTLAND: This responds to your request for a report on S. 1356, a bill to amend the Judicial Code to permit Indian tribes to maintain civil actions in Federal district courts without regard to the $10,000 limitation, and for other purposes.

We recommend that the bill be enacted.

The bill removes the $10,000 jurisdictional limitation upon civil litigation in the U.S. district courts by Indian tribes when the matter in controversy arises under the Constitution, laws, or treaties of the United States.

The Judicial Conference has endorsed the bill on the grounds that (1) it presents no difficulty of judicial administration, and (2) it is in line with recently enacted statutes conferring Federal question jurisdiction without regard to the amount of money involved. We concur in that view.

In addition, it is particularly appropriate to remove the $10,000 limitation with respect to litigation involving tribal lands that are or were held by the United States in trust for the tribe, or by the tribe subject to a restriction against, alienation imposed by the United States. The issues involved are Federal issues and the tribes should not be required to conduct the litigation in the State courts.

It should be noted that the United States as trustee can initiate the litigation in the Federal courts, and often does so. Occasionally, however, the U.S. attorney declines to bring an action, and the tribes should then have access to the Federal courts through their own attorneys.

The new section added to title 28 of the United States Code should be section 1362 rather than section 1361.

We also suggest that the bill should add the new section 1362 to the table of contents for chapter 85 that precedes section 1331.

The Bureau of the Budget has advised that there is no objection to the presentation of this report from the standpoint of the administration's program.

Sincerely yours,

HARRY R. ANDERSON,
Assistant Secretary of the Interior.

ADMINISTRATIVE OFFICE OF THE U.S. COURTS,
SUPREME COURT BUILDING,
Washington, D.C., October 1, 1965.

Hon. JAMES O. EASTLAND,
Chairman, Committee on the Judiciary,
U.S. Senate, Washington, D.C.

DEAR SENATOR EASTLAND: This is in further reply to your request of March 11, 1965, for the views of the Judicial Conference of the United States on S. 1356, a bill to amend the judicial Code to permit Indian tribes to maintain civil actions in Federal district courts without regard to the $10,000 limitation, and for other purposes.

At its recent session on September 22–23, 1965, the Judicial Conference voted to approve this legislation. The Conference believes that the elimination of the $10,000 jurisdictional limitation upon civil litigation of Indian tribes would present no difficulty of judicial administration and would be in line with the more recently enacted statutes conferring Federal question jurisdiction which do not contain a monetary limitation.

It should be noted that the proposed section 1361 of title 28 of S. 1356 should be numbered 1362 as the previous number is already in use.

Sincerely,

WILLIAM E. FOLEY,
Deputy Director.

U.S. DEPARTMENT OF JUSTICE,
OFFICE OF THE DEPUTY ATTORNEY GENERAL,
Washington, D.C., March 4, 1966.

Hon. JAMES O. EASTLAND,
Chairman, Committee on the Judiciary,
U.S. Senate, Washington, D.C.

DEAR SENATOR: This is in response to your request for the views of the Department of Justice on S. 1356, a bill to amend the Judicial Code to permit Indian tribes to maintain civil actions in Federal district courts without regard to the $10,000 limitation, and for other purposes.

Under existing law the district courts have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of $10,000, exclusive of interest and costs, and arises under the Constitution, laws, or treaties of the United States (28 U.S.C. 1331(a)). The $10,000 jurisdictional amount is, of course, not applicable to actions brought in the name of the United States to enforce rights of Indian tribes arising under the Constitution, laws, or treaties of the United States (28 U.S.C. 1345). The bill would amend the Judicial Code by adding a new section under which the district courts would be vested with original jurisdiction of all civil actions, brought by any Indian tribe or band with a governing body duly recognized by the Secretary of the Interior, wherein the matter in controversy arises under the Constitution, laws, or treaties of the United States.

The effect of the bill would be to remove insofar as actions brought by Indian tribes are concerned, the $10,000 limitation provided in section 1331(a) of title 28 and thus permit them to maintain actions

in the U.S. courts without any limitation on the amount in controversy, where the case arises under the Constitution, laws, or treaties of the United States. One of the purposes of the bill apparently is to overcome the effect of the decision in the case of *Yoder* v. *Assiniboine and Sioux Tribes*, 339 F. 2d 360 (1964) which held that the Federal courts did not have jurisdiction of an action brought by the Indian tribes involving oil and gas well spacing on tribal lands because the tribes failed to show that the jurisdictional amount of $10,000 was involved.

As indicated above the *Yoder* case involved the power of a State to control oil and gas well spacing on Indian lands. Other suits which might be brought in the Federal courts under the bill would include actions to quiet title to land claimed by Indian tribes, including actions to set aside patents where it is alleged the patents infringe upon rights claimed by the tribes under the Constitution, laws, or treaties of the United States and actions for the protection of powers of tribal self-government. While an accurate estimate cannot be made of the number of cases which might result from the enactment of the bill, there is no reason to believe the number would be large.

Whether the bill should be enacted involves questions of policy on which the Department of Justice prefers to make no recommendation. However, if the bill is to receive favorable consideration it is suggested that since there presently is a section 1361 of title 28, United States Code (Public Law 87–748; 76 Stat. 744) the bill should be amended by substituting "1361" for "1360" on line 4 and by substituting "1362" for "1361" on line 5 and again on line 6 of the bill.

The Bureau of the Budget has advised that there is no objection to the submission of this report from the standpoint of the administration's program.

Sincerely,

RAMSEY CLARK,
Deputy Attorney General.

CHANGES IN EXISTING LAW

In compliance with subsection (4) of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

CHAPTER 85, TITLE 28, UNITED STATES CODE

§ 1361. * * *

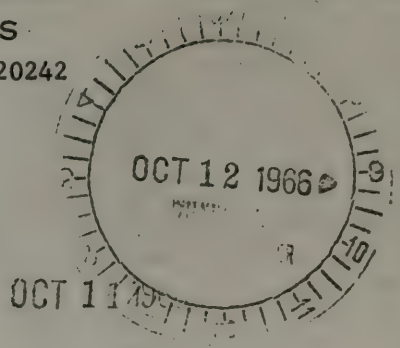
"§ 1362. Indian tribes.

"The district courts shall have original jurisdiction of all civil actions, brought by any Indian tribe or band with a governing body duly recognized by the Secretary of the Interior, wherein the matter in controversy arises under the Constitution, laws, or treaties of the United States."

O

UNITED STATES
DEPARTMENT OF THE INTERIOR
BUREAU OF INDIAN AFFAIRS
WASHINGTON, D.C. ~~20240~~ 20242

Tribal Operations



Mr. Charles A. Hobbs
1616 H Street, N. W.
Washington, D. C. 20006

Dear Mr. Hobbs:

This will refer to your letter of October 6 requesting a statement from us that the Quinault Tribe has a governing body duly recognized by the Secretary of the Interior.

Both the Department of the Interior and the Bureau of Indian Affairs recognize the business committee of the Quinault Tribe as having the authority to represent the Indians of the Quinault Reservation in tribal matters as specified in the bylaws. The business committee consists of the elected officers of the tribal council which is composed of the voting members of the tribe.

We hope this statement is sufficient to satisfy your needs.

Sincerely yours,

William E. Finale

Deputy Assistant Commissioner

In the United States Court of Appeals
for the Ninth Circuit

No. 19868

QUINAULT TRIBE OF INDIANS, et al., Appellants,

v.

A. M. GALLAGHER, et al., Appellees.

APPELLANTS' REPLY TO BRIEF OF THE UNITED STATES, AMICUS CURIAE

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Of Counsel

FILED
MAY 31 1966
WM. B. LUCK, CLERK

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In the United States Court of Appeals
for the Ninth Circuit

No. 19868

QUINAULT TRIBE OF INDIANS, et al., Appellants,

v.

A. M. GALLAGHER, et al., Appellees.

APPELLANTS' REPLY TO BRIEF OF THE
UNITED STATES, AMICUS CURIAE

I. The District Court had federal question jurisdiction under the provisions of 28 U.S.C. 1331.

A. The amicus suggests (amicus brief, pp. 4-5) that ". . . the District Court had no authority to entertain the suit for lack of allegations [in the Complaint] supporting the bald allegation (Par. 1) that the 'matter in controversy exceeds the value of $10,000'. . . ." Stated otherwise, the amicus argues that it was not enough for us to assert that the amount in controversy exceeded $10,000 but that we were required, in the Complaint, to provide detailed allegations to support our basic allegation.

The point is a technicality and in error to boot. We have made clear in detail how the $10,000

jurisdictional sum is derived,[1] and obviously we are prepared to prove these details at trial if the Court finds a trial necessary. Evidently, the amicus feels these details should have appeared in the Complaint, as a jurisdictional requirement. On the contrary, the simple allegation in the Complaint that the amount in controversy exceeds the jurisdictional amount is all that is required by the statute, as a glance at the Federal Rules of Civil Procedure, Appendix, Form 2, will confirm. See also Moore Federal Practice, 2-1668, 1-834.

There is nothing to the contrary in Giancana v. Johnson, 335 F.2d 366 (7th Cir. 1964), cert. den., 379 U.S. 1001.[2] Contrary to the amicus contention, the allegations in the complaint in the Giancana case were not similar to those in the instant case. In that case, as the Court stated, the complaint contained "no express allegation of the essential jurisdictional sum or value." (335 F.2d at 368) i.e., the complaint did not state that the amount in controversy exceeded $10,000. In the instant

1. Plaintiffs' Opposition to Motion to Dismiss, District Court, Nov. 4, 1964, pp. 19-20; and Appellants' Reply Brief before this Court, June 7, 1965, pp. 7-11.

2. The amicus has cited a number of cases (Brf., p. 3) standing for the proposition that, no matter how important the question, federal question jurisdiction under 28 U.S.C. 1331 does not lie unless the plaintiff can show the presence of the jurisdictional amount in controversy. With this proposition we are in complete agreement.

case, as stated above, our Complaint made the necessary allegation.[3]

B. It is interesting to note that the amicus brief is silent on the point of whether our Complaint raised a substantial federal question - a point that has been vigorously disputed by the parties to this litigation.[4] We take this silence to signify that the amicus agrees with appellants on this point since every other point discussed in the amicus brief has taken a position contrary to that of the appellants. If this be the case, it seems to us that the amicus might have said so, and thus seemed a little less the advocate and a little more the friend of the Court.

II. The State of Washington's assumption of jurisdiction over the Quinault Tribe was unlawful.

A. In discussing the merits of appellants' case, the amicus brief begins by asserting (pp. 5-6) that it is for Congress rather than for the courts to

3. The United States also makes the point (Brf., p. 5) that "the complaint does not allege any facts showing any actionable violation of civil rights such as would be sufficient to invoke the jurisdiction of the District Court under 28 U.S.C. 1343." We find this bald assertion, made without any further argument, puzzling, indeed. In our main brief, pp. 33-38, we very carefully pointed out why the District Court had jurisdiction under 28 U.S.C. 1343. Since the United States did not see fit to refute any of the arguments we made, we do not believe that its pronouncement on this matter is entitled to any weight.

4. See Appellees' Brief, pp. 5-14; Appellants' Reply Brief, pp. 1-7.

to determine when ". . . Indian tribes shall cease to be dependent and assume the responsibilities of citizenship."

This point is irrelevant to this case.[5/] Appellants have never contended that Congress lacked power to relinquish jurisdiction to the State of Washington. Appellants' contention is and has always been that the State of Washington failed to comply with the terms of Congress' offer to relinquish jurisdiction; thus its attempted assumption of jurisdiction over the Quinaults, and other Indian tribes in the State, was null and void.

The amicus brief then - after discussing the background of the passage of Public Law 280, and inaccurately reciting the history of the State's assumption of jurisdiction over the Quinaults[5a/] - goes on blandly to assert that

5. And rather presumptuous, considering the source. A more accurate way of stating it would be to say it is up to Congress to decide whether to cast the Indians adrift at a time when they are still not capable of achieving economic equality in the local non-Indian environment. The Indians regard State jurisdiction as a giant step toward loss of what remains of their reservation, of their tribal government, and of their sense of tribal identity.

5a. The amicus brief states that the Business Committee petitioned the Governor for state jurisdiction and that thereafter ". . . a dissident group of Quinault Indians claimed that the business committee was not properly clothed with authority to adopt the resolution. . . ." (p. 7). In point of fact the Business Committee, and this is alleged in our Complaint, acted against the will of the overwhelming majority of the Tribal Council (an assembly of the whole Tribe) which had given the Business Committee express instructions not to petition for state law and order. The so-called "dissident group" was (and is) in fact the overwhelming majority of the Tribe. These facts were recognized by the Governor in rescinding his proclamation (see our main brief, p. 6, note 2), and by the trial court in State v. Bertrand, 61 Wash.2d 333, 378 P.2d 427 (1963); the trial court was reversed, but on other grounds.

Public Law 280 did not direct the method by which the states could acquire civil and criminal jurisdiction over Indians but left that question entirely to the determination of each state, and that consequently whether a state has lawfully assumed jurisdiction under Public Law 280 is a question of state law. But Congress *did* direct the method by which *certain* states - those with constitutional disclaimers - could take jurisdiction. Section 6 of Public Law 280 expressly directed:

> ". . . That the provisions of this Act *shall not* become effective with respect to such assumption of jurisdiction by any such State *until the people thereof have appropriately amended their State constitution* or statutes as the case may be." 6/ (Emphasis supplied.)

The amicus brief (p. 8) points to the fact that whether states have the authority to prosecute Indians under state law is a question of state law, and that the construction of state law by the highest court of the state is binding on the federal courts. We do not disagree with these conclusions. There is a question of state law in this case, *i.e.*, whether the Washington State assumption of jurisdiction complied with the provisions of the Washington State Constitution. On that question of state law the decision of the Washington State Supreme Court in *State* v. *Paul*, 53 Wash.2d 789, 337 P.2d 33 (1959) - although we believe it to be erroneous - is binding on federal courts.

6. See discussion in our main brief, pp. 20-25.

What the amicus overlooks, however, is that the failure of the State of Washington to amend its Constitution raised not only a question of state law (whether the constitutional disclaimer could be ignored consistent with the State Constitution) but also a question of federal law (whether the constitutional disclaimer could be ignored consistent with Public Law 280). Under the plain language of Public Law 280, made even clearer by its legislative history,[7] Washington failed to satisfy the mandate of Public Law 280, and thus remained ineligible to assume jurisdiction. It is of no direct interest to us, or to this Court, whether the State court found that state law was satisfied.

B. We assert that, entirely aside from Public Law 280, the Federal Enabling Act that admitted the State of Washington into the Union required the Washington State Constitution to include a provision that ". . . Indian lands shall remain under the absolute jurisdiction and control of the Congress of the United States . . ."[8] and that this Constitution be ". . . irrevocable without the consent of the United States and the people of the said states. . . ." Therefore, we argue, the action of the Legislature of the State of Washington in assuming

7. See Brf., pp. 20-25.

8. 25 Stat. 676, 677.

jurisdiction over Indian reservations without obtaining the consent of the people of the State to an amendment of the Constitution violated the provisions of the Enabling Act.[9/]

The amicus brief does not discuss our assertions that insofar as the Enabling Act prevented the State of Washington from assuming jurisdiction over Indian reservations, the consent of the people through constitutional amendment rather than action by the Legislature had to be obtained. Rather, the amicus brief (pp. 9-11) points out that "absolute" federal jurisdiction over Indian lands, as that phrase appears in several enabling acts, does not really mean exclusive federal jurisdiction, because the states do have jurisdiction on Indian reservations in certain cases. Amicus then (p. 11) sums up as follows (a passage we quote in full because we are not sure we understand it well enough to paraphrase):

> "In view of the rulings of the Supreme Court of the United States that the words 'absolute jurisdiction and control of the United States' in Washington's Enabling Act and other statehood laws do not mean that Indian lands are under the exclusive jurisdiction of the United States, it follows that there was no legal impediment in the same language as incorporated in Article XXVI of the State Constitution to Washington's assumption of the jurisdiction offered by Public Law 280 by legislative action, without prior amendment to Article XXVI. . . ."

9. See discussion in main brief, pp. 25-30.

We agree that notwithstanding the "absolute" federal jurisdiction clauses in several enabling acts (such as Washington's), the states do have jurisdiction on Indian reservations in certain cases. However, it is important to note that those are all cases involving non-Indians. We are aware of no case which has held that a state has jurisdiction over an Indian on a reservation, unless Congress consented to it.[10]

Restating amicus' reasoning in more precise terms, then, it apparently comes to this: since the state has judicially recognized jurisdiction over non-Indians within Indian reservations, despite the fact that its Constitution recognizes "absolute" federal jurisdiction over such lands, therefore it follows that the state need not amend its Constitution in order to take jurisdiction over Indians within such lands. The fallacy is obvious - an exception to "absolute" federal jurisdiction on reservations with respect to non-Indians does not by any means authorize an exception with respect to Indians. After all,

10. See Williams v. Lee, 358 U.S. 217, 221 (1959): ". . . when Congress has wished the States to exercise this power [criminal and civil jurisdiction within a reservation] it has expressly granted them the jurisdiction. . . ." In the Kake case cited by amicus, the question involved fishing rights not located within any reservation. Indeed, the Kake Indians had no reservation at all, so the essential question of state regulation of Indians within a reservation never arose. It did arise in a companion case, Metlakatla, 369 U.S. 45, which involved a reservation and reached the opposite result. The Court in Kake pointed out the fact that Metlakatla involved a reservation while Kake did not. (369 U.S. at 64.)

the exclusive federal jurisdiction which ever really matter historically is that over the Indians, not over non-Indians.[11/]

While the amicus may be technically correct in stating that the federal jurisdiction over the Quinault Reservation was not "exclusive" in its scope, this in no way validates the attempt of the State of Washington to take over that jurisdiction. Whatever the scope of federal jurisdiction on the Quinault reservation, the State could only take it over if it complied with the provisions of the Enabling Act and of Public Law 280.

The question in dispute in this case - and the question to which the parties have heretofore addressed themselves - is whether this "absolute" (though not exclusive) federal jurisdiction could be assumed

11. See New York v. Martin, 326 U.S. 496, 501 (1946), in upholding state jurisdiction over a non-Indian on a reservation: ". . . Generally no emphasis has been placed on whether state or United States courts should try white offenders for conduct which happened to take place upon an Indian reservation, but which did not directly affect the Indians. . . ." See also, Utah & No. Ry. v. Fisher, 116 U.S. 28, 31-32 (1880).

by act of the Legislature, as contended by appellees, or, because of the requirements of two federal laws, Public Law 280 and the Enabling Act, only by action of the "people" through constitutional amendment.

C. The Kake case quoted by amicus refers to the Williams case, supra, which suggests still another factor of relevance here. In the Williams case the Supreme Court noted that the Navajo-United States relationship involved a treaty, and -

> ". . . Implicit in these treaty terms . . . was the understanding that the internal affairs of the Indians remained exclusively within the jurisdiction of whatever tribal government existed." (358 U.S. at 221-222).

We suggest that the same understanding was clearly implicit in the Quinault Treaty of 1855, 12 Stat. 971.[12/] Of course, the Williams case did not involve Public Law 280, which if properly implemented by Washington, would have abrogated the implicit understanding in the Quinault Treaty. However, Williams does establish a presumption in favor of Indian self-government and makes it absolutely clear that states should not be allowed to ". . . infringe on the right of the Indians to govern themselves . . ." unless there has been an effective delegation of power to the states by the Congress. (358 U.S. at 223).

12. See, e.g., the language of Article II: the reservation was to be set aside for the "exclusive" use of the Indians, ". . . and no white man shall be permitted to reside thereon [on the reservation] without permission of the tribe. . . ."

In the instant case, we have shown that no such delegation of authority to the State of Washington was effectively made by the Congress since the State of Washington did not comply with the provisions of Public Law 280 or of the Enabling Act.

If Congress meant what it said in Public Law 280, (i.e., ". . . That the provisions of this Act shall not become effective with respect to such assumption of jurisdiction by any such State until the people thereof have appropriately amended their State constitution or statutes as the case may be. . .") it follows that the Washington State assumption of jurisdiction was a nullity. Neither the appellees nor the amicus have offered any interpretation of Public Law 280 which would lead to a contrary result. Indeed, appellants' interpretation of this statute is the only tenable one, in light of the legislative history, and especially in light of the long-settled rule that treaties and statutes affecting the Indians should be construed in their favor.[13/]

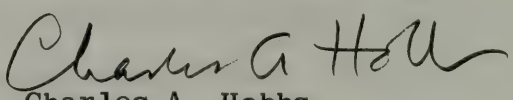
13. See, for example, Worcester v. Georgia, 31 U.S. (6 Pet.) 515, 582 (1832); The Kansas Indians, 72 U.S. (5 Wall.) 737, 760 (1866); Choctaw Nation v. United States, 119 U.S. 1, 27-28 (1886); Jones v. Meehan, 175 U.S. 1, 11 (1899); United States v. Winans, 198 U.S. 371, 380 (1905); Winters v. United States, 207 U.S. 564, 576 (1908); Choate v. Trapp, 224 U.S. 665, 675 (1912); Alaska Pacific Fisheries v. United States, 248 U.S. 78, 89 (1918); Seufert Brothers Co. v. United States, 249 U.S. 194, 198 (1919); Carpenter v. Shaw, 280 U.S. 363, 367 (1930); Squire v. Capoeman, 351 U.S. 1, 7 (1956).

CONCLUSION

Appellants regret that righting the wrong done them by the State of Washington will require the State to start all over again in its efforts to take jurisdiction over Indian lands. On the other hand, what Congress required makes sense - such a far-reaching change in Indian-state relations should require constitutional authorization, particularly where the Constitution expressly forbids what the state has tried to do here.

WHEREFORE, the judgment of the District Court should be reversed, and the case remanded with instructions to grant the relief sought by appellants.

Respectfully submitted,



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WILKINSON, CRAGUN & BARKER
Jerry C. Straus

LESOURD & PATTEN

Gladys Phillips
Of Counsel

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing reply brief is in full compliance with those rules.

Charles A. Hobbs

CERTIFICATE OF SERVICE

Served this 27th day of May, 1966, by mailing a copy each of Appellants' Reply to Brief of the United States, Amicus Curiae, to the attorneys for appellees: Jane Dowdle Smith, Assistant Attorney General, Temple of Justice, Olympia, Washington, and L. Edward, Esquire, Prosecuting Attorney for Grays Harbor County, P. O. Box 529, Montesano, Washington.

Charles A. Hobbs

No. 19877

In the

United States Court of Appeals

FOR THE NINTH CIRCUIT

SOUTHERN ARIZONA YORK REFRIGERATION COMPANY, *et al.*,

Appellant,

vs.

THE BUSH MANUFACTURING COMPANY, *et al.*,

Appellee.

APPELLEE'S PETITION FOR REHEARING.

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No. 19877

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United States Court of Appeals

FOR THE NINTH CIRCUIT

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Appellant,

vs.

THE BUSH MANUFACTURING COMPANY, *et al.*,

Appellee.

APPELLEE'S PETITION FOR REHEARING.

Appellee respectfully petitions the Court for a rehearing of this appeal upon the following grounds:

I.

The Quoted Portion of Appellee's Brief in the Opinion on Page 6 Thereof Is Taken Out of Context.

The point made by appellee was that the burden of proving that a standard of care was not met is upon the plaintiff, not on defendant. Plaintiff failed in its proof.

To be correct the quoted portion on page 6 of the opinion should end with the words "if the plaintiff proves by a preponderance of the evidence that the custom does not meet the standard."

II.

The Trial Court Did Not Rely Solely on the Finding of "Custom and Usage" but Took Into Consideration the Actual Methods of Manufacture, Control and Testing by Appellee.

The evidence recited on pages 8 and 9 of Appellee's brief shows clearly the care with which the units were designed, manufactured and tested which in and of itself could be considered by the trial court as overcoming the inference of negligence, and, which is sufficient under Arizona law to rebut such an inference.

III.

The Intent and Purpose of the Finding of Fact "That Plaintiff Knew That Said Coils Had Leaked at Three Specific Times and at Least One or Two Months Before December 3rd and 4th, 1955," Was to Show Knowledge on the Part of Plaintiff.

It was a finding that plaintiff had:

(1) assumed the risk of injury from any further leaks in the coils, having been fully advised of the leakage problem, and

(2) was contributorily negligent in not demanding a replacement of the coils when the express warranty upon which it was held liable in the first action was not known to Appellee. Further, by the execution of its express warranty which went far beyond the warranty of Appellee, and far beyond the Sales Act of Arizona, it assumed the risk of injury resulting from defective operation.

IV.

There Is a Failure of Proximate Cause If Recovery by Plaintiff Herein Is Really Based on Equitable Indemnity for Negligence.

No injury or damage to the meat in the storage room would have occurred if the door between the refrigeration room, in which were located the coils, and the storage room had been in good working order and repair so that it would not have opened and allowed the gas to escape into the storage area. The original purpose of separation of rooms was thus frustrated.

V.

This Court Has Applied Its Own Judgment for That of the Trial Court.

The Court has done violence to Arizona law, as set forth on pages 13 through 17 of Appellee's brief, and has applied "federal law" rather than state law to the actions of the trial court. The "clearly erroneous" theory as set forth on page 7 of the opinion was born of federal law as set forth in *United States v. United States Gypsum Company,* 333 U.S. 364, at 395 (1948), a Sherman-Anti-Trust case, *United States v. Munz,* 352 F. 2d 196 (9th Cir. 1965), a case involving a federal statute, and other cases involving federal statutes, and does not apply to product liability cases which are bottomed on state law; in this instance, Arizona. "Federal law" should not be used in this case.

VI.

The Findings of No Negligence in Manufacture and Design Are Not "Clearly Erroneous."

To so find the Court must completely disregard:

(a) The trial court's consideration of *all* the evidence

(b) Contributory negligence

(c) Assumption of risk

(d) Arizona law

(e) The extreme diffculty in overcoming the inference of negligence in view of the lapse of time between manufacture and trial (approximately 9 years)

(f) The inference that it is applying the "strict liability" test of product liability and is doing only lip service to the doctrine and theory of negligence.

Appellee respectfully requests that this Honorable Court grant a rehearing of this appeal and that the judgment thereafter be affirmed.

Respectfully submitted,

TREMAINE & SHENK,
By JOHN W. SHENK,
Attorneys for Appellee.

Dated May 19, 1966.

Certificate.

I hereby certify that in my judgment the petition for rehearing is well founded and further certify that it is not interposed for delay.

JOHN W. SHENK,
Attorney for Appellee

NO. 19881

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

HAROLD EUGENE WENZLER, JR.,

Appellant,

vs.

PETER PITCHESS, Sheriff of Los Angeles County, et al.,

Appellees.

See also Vol. 3344

PETITION FOR REHEARING

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA
CENTRAL DIVISION

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FILED

NO. 19881

IN THE UNITED STATES COURT OF APPEALS

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NO. 19881

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

HAROLD EUGENE WENZLER, JR.,

Appellant,

vs.

PETER PITCHESS, Sheriff of Los Angeles County, et al.,

Appellees.

PETITION FOR REHEARING

TO: THE HONORABLE JUDGES OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT:

HAROLD EUGENE WENZLER, JR., the appellant above named, presents this, his Petition for Rehearing, in the above entitled cause, and, in support thereof, respectfully shows:

1. The Court, in its opinion of affirmance herein, failed to consider the scienter issue raised by appellant. As appears from the Petition for Writ of Habeas Corpus:

"(c) The trial court construed §311.2 of the California Penal Code as dispensing with proof of knowledge of obscenity and authorizing conviction solely on alleged circumstantial proof of 'contents'. In so construing the statute, the courts below arbitrarily deprived petitioner

of his liberty without due process of law and abridged the exercise of freedoms of speech and press guaranteed by the First and Fourteenth Amendments to the United States Constitution. Smith v. California, 361 U.S. 147, 80 S.Ct. 215, 4 L.Ed. 205." (R. 7a) 1/

In Mishkin v. New York, 86 S.Ct. 958, Mr. Justice Brennan made plain that mere knowledge of contents of a work was insufficient to meet the constitutional requirements laid down in Smith v. California, 361 U.S. 147, 80 S.Ct. 215, 4 L.Ed. 205. See 86 S.Ct. at 962, n. 5; 964-965.

The importance of this issue is attested to by the grant of writs of certiorari in the cases of Austin v. Kentucky, October Term, 1965, No. 453; and Redrup v. New York, October Term, 1965, No. 72, on April 25, 1966.

2. The Court, in its opinion of affirmance herein, failed to consider the issue presented in United States v. Klaw, et al., 350 F.2d 155 (2 Cir. 1965), raised by appellant. In his petition for a writ of habeas corpus, appellant alleged that:

"(g) (i) The State Court held that the prosecution need not prove, other than by the film itself, that the film went beyond customary limits of candor. The Court said (C. T. 159):

" 'Well, so there will not be any misunderstanding

1/ The reference "R" is to Volume I of the Transcript of Record on Appeal herein. The reference here is to page 7 of the Petition for Writ of Habeas Corpus. The particular page is unnumbered in the Record, but comes between R-7 and R-8.

and so that your record will be protected, I want to state clearly that in my opinion, the matter of contemporary standards with relation to the average man, average person, as used in the section, that is Section 311.2, or the definition section, may be determined by the Court or by the Jury without the admission of any other outside testimony, after having seen the picture or reviewed the book.' " (R. 9).

In United States v. Klaw, et al., supra, the Court held it a denial of due process of law, as well as a violation of the free speech provisions of the Constitution, to permit a jury to find a challenged work obscene without evidence that the work goes substantially beyond customary limits of candor and appeals to the prurient interest of the average person.

3. In holding that appellant's conviction should stand, notwithstanding the fact that he was tried under unconstitutional standards, the Court overlooked the case of Cole v. Arkansas, 333 U.S. 196, 68 S.Ct. 514, 92 L.Ed. 644, which holds that conviction on a charge neither made, nor tried, nor submitted to the fact-finder is a clear deprivation of liberty without due process of law. It is plain that when appellant was convicted in the Municipal Court, and his conviction was affirmed in the Appellate Department, those courts failed to apply the constitutional tests required by Zeitlin v. Arnebergh, 59 Cal.2d 901, 383 P.2d 152, 31 Cal.Rptr. 800; Jacobellis v. Ohio, 378 U.S. 184, 84 S.Ct. 1676, 12 L.Ed.2d 793; Smith v. California, 361 U.S. 147, 80 S.Ct. 215, 4 L.Ed. 205; and United

States v. Klaw, et al., 350 F. 2d 155 (2 Cir. 1965). The mere fact that this Court believes the material is "hard core pornography" is no assurance that the California courts would have come to the same conclusion. See People v. Schackman, Appellate Department, Superior Court of Los Angeles County, No. CR. A-5272 (decided December 4, 1963), unreported. As a minimum, due process of law requires that appellant be given an opportunity to be heard in the trial court on the issue of whether or not the material is "hard core pornography". Cole v. Arkansas, supra, 333 U. S. at 201. See also United States v. Grant and Wissman (9th Cir. No. 17865).

4. The Court clearly erred in finding the film to be hard core pornography. See Excellent Publications, Inc. v. United States, 309 F. 2d 362 (1 Cir. 1962); and Humor Magazine, Inc. v. United States, 311 F. 2d 576 (1 Cir. 1963). The film in question is a "nudie" type moving picture. The woman in the film does not appear with other persons; the genital areas are not exposed; there is nothing but nudity in the film; the film was not provocatively advertised and, indeed, was sold in a plain white container.

While Mr. Justice Stewart indicated in Jacobellis v. Ohio, 378 U. S. 184, 84 S. Ct. 1676, 12 L. Ed. 2d 793, that he doubted his ability to define "hard core pornography", adding he "knew it when he saw it", in Ginzburg v. United States, 86 S. Ct. 942, 957, n. 3, he described the kind of material he had in mind.

Plainly, it is respectfully submitted, the film here does not meet Mr. Justice Stewart's definition of "hard core pornography". The Appellate Department held in People v. Schackman, supra, that

a film which depicted at least as much as was depicted in the film herein was not hard core pornography. The Appellate Department was apparently of the view that unless the film depicted "acts of sexual intercourse", or some of the other representations described by Mr. Justice Stewart, it could not be condemned as obscene, no matter how objectionable it might appear to be.

WHEREFORE, upon the foregoing grounds, it is respectfully urged that this Petition for Rehearing be granted, and that the judgment of the District Court be, upon further consideration, reversed.

Respectfully submitted,

STANLEY FLEISHMAN

Attorney for Appellant.

CERTIFICATE OF COUNSEL

I, Stanley Fleishman, attorney for appellant, do hereby certify that the foregoing Petition for Rehearing of this cause is presented in good faith and not for purposes of delay.

/s/ Stanley Fleishman

STANLEY FLEISHMAN

Sealed
Vol. 3344

No. 19,882

United States Court of Appeals

For the Ninth Circuit

SOUTHERN PACIFIC LAND COMPANY,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

Upon Appeal from the United States District Court for the Southern District of California Northern Division

Honorable M. D. Crocker, Judge

APPELLANT'S REPLY BRIEF

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No. 19,882

United States Court of Appeals

For the Ninth Circuit

SOUTHERN PACIFIC LAND COMPANY,	*Appellant,*
VS.	
UNITED STATES OF AMERICA,	*Appellee.*

Upon Appeal from the United States District Court for the Southern District of California Northern Division

Honorable M. D. Crocker, Judge

APPELLANT'S REPLY BRIEF

I

COMMENT ON APPELLEE'S BRIEF

A reading of the brief filed by the United States demonstrates a failure on its part to recognize any distinction between the court's right to review a determination by a governmental officer that the taking of defendant's property is necessary for or advantageous to the public use authorized by the statute and the power of the court to review an arbitrary taking of private property without such a determi-

nation for a use or uses other than the use authorized by the statute.

The United States claims, and the District Court held, that when the Secretary of the Navy decided that the United States would take the oil, gas and mineral rights underlying these properties that decision was final and the District Court had no jurisdiction to review the decision.

Southern Pacific Land Company claims (1) that there was no determination by the Secretary of the Navy that defendant's oil, gas and mineral rights were necessary for or advantageous to the use authorized by the statute under which this condemnation was made and that even if such a determination on the part of the Secretary of the Navy would have been binding upon the court, a decision to take without such determination is subject to review; and (2) that even such a determination of necessity is subject to review if it affirmatively appears that such determination was not in good faith or was arbitrary or capricious or an abuse of the discretion given to the Secretary of the Navy under the statute.

The Secretary of the Navy had no authority to take any estate in defendant's lands except under Public Law 968 (United States Statutes Volume 70, Chapter 939) which authorized him to acquire property *to establish a Naval Air Station at Lemoore, California.* The Complaint in Condemnation was filed pursuant to this authority and pursuant to Title 40 USCA Section 257 which provides that where a governmental officer has been authorized to procure real estate *for*

a public use he may acquire the same by condemnation *whenever in his opinion it is necessary or advantageous to the government to do so.* The Complaint in Condemnation alleges that the use for which the estate is taken is the establishment of a Naval Air Station at Lemoore, California, and for *military and naval purposes* in connection therewith. The Declaration of Taking Act (Title 40 USCA Section 258(a)) expressly requires as a condition precedent to the taking a Declaration of Taking stating *the public use* for which the estate is taken. The Declaration of Taking in this case states that these properties were taken *"for military and naval purposes for the establishment of a Naval Air Station, Lemoore, California."*

Thus, it is clear from the Act of Congress authorizing the taking, from the Complaint in Condemnation, and from the Declaration of Taking that the Secretary of the Navy had no authority to take these properties for any use other than military or naval uses connected with Lemoore Naval Air Station. Yet, Mr. Bantz testified under oath that when he made his decision to take the oil, gas and mineral rights he knew that they would not and could not be used for those purposes and that his decision to condemn these rights was based on the possibility of speculative future uses in no way connected with the military or naval purposes of Lemoore Naval Air Station.

Defendants alleged in their answer that the taking of the oil, gas and mineral rights was not for a public use or for the purposes of the Naval Air Station and that under these circumstances Mr. Bantz's decision

to take the oil, gas and mineral rights was arbitrary, capricious and unreasonable and an abuse of discretion. In spite of the District Court's denial of its motion to strike these defenses the United States refused to produce any testimony upon the subject and in its brief refuses to comment upon the testimony of Mr. Bantz.

We submit that the distinction between the jurisdiction of the court to review an exercise of the discretion given to the Secretary of the Navy to determine the necessity for the taking for the use authorized, and the power of the court to review an arbitrary taking without such determination or for other purposes is a real one and is decisive on this appeal, and that when considered in the light of this distinction appellant's position is supported by all of the decisions cited both by the United States and by Southern Pacific Land Company.

II

THE DECISIONS CITED BY THE UNITED STATES DO NOT SUPPORT ITS POSITION

The United States has cited more than fifty decisions in its brief. It is impossible to discuss each of those decisions if this brief is to be kept to any length which would be acceptable to this court. However, we are convinced that when properly analyzed in the light of their facts none of those decisions supports the position taken by the United States in the present

case, and we do wish to discuss those decisions most heavily relied upon by appellee.

In this connection we offer the following general comments:

1. With one exception (*United States v. Mischke,* infra), none of the decisions cited by the United States speaks in terms of "jurisdiction". Some of those decisions, in passing upon the exercise of a governmental officer's discretion to determine the necessity for taking property, hold that the court is bound by such determination and will not interfere with such an exercise of discretion under the circumstances there existing. However, in practically every instance the court did review the facts as a basis for its decision.

2. No case is cited in which the governmental officer made a decision to take private property without first making a determination that its taking was necessary or advantageous to a use authorized by the statute.

3. No case is cited in which the governmental officer who made the decision to take testified concerning his determination of the necessity for the taking or in which he testified that the property so sought to be taken could not be used and was not intended to be used for the purpose authorized by the statute. To our knowledge the case at bar is a case of first impression where such testimony is present.

4. The question of whether a court will review the determination of a governmental officer that the tak-

ing is necessary for the purpose authorized upon the ground that such taking is in bad faith or arbitrary, capricious or unreasonable or an abuse of discretion, has not finally been decided. The Supreme Court has expressly left this question open. The Circuit Courts of Appeal are in conflict.

A. The Supreme Court Decisions

In its opening brief Southern Pacific Land Company cited and discussed *City of Cincinnati v. Vester,* 281 U.S. 439, 50 SCR 360. We ask the court to carefully consider the analysis of that case contained in our opening brief. In that case, a governmental agency attempted to condemn an estate in land lying outside of that required for immediate use and attempted to justify the excess taking upon the basis of uses not authorized by the ordinance which authorized the condemnation. The Supreme Court called attention to the fact that the municipality was required to specify definitely the purpose of the appropriation (as was the United States in the present case under the Declaration of Taking Act) and held that the condemnation could not be justified for uses not so specified. The following language of the Supreme Court is particularly applicable.

> "It is well established that, in considering the application of the Fourteenth Amendment to cases of expropriation of private property, the question of what is a public use is a judicial one. . . . The question remains a judicial one which this Court must decide in performing its duty of enforcing the provisions of the Federal Constitution."

"We are thus asked to sustain the excess appropriation in these cases upon the bare statements of the resolution and ordinance of the city council, by considering hypothetically every possible, but undefined, use to which the city may put these properties, and by determining that such use will not be repugnant to the rights secured to the property owners by the Fourteenth Amendment.

* * *

". . . The city's contention is so broad that it defeats itself. It is not enough that the property may be devoted hereafter to a public use for which there could have been an appropriate condemnation. Under the guise of an excess condemnation pursuant to the authority of the constitutional provision of Ohio, private property could not be taken for some independent and undisclosed public use."

We repeat our contentions that *Cincinnati v. Vester* is direct authority here where the United States seeks to condemn an excess estate in appellant's lands for uses other and beyond those authorized by Congress and stated in the Declaration of Taking. In the words of the Supreme Court in *Cincinnati,* this court is asked to sustain this excess appropriation upon the bare statements in the Declaration of Taking and Complaint in Condemnation and by considering hypothetically possible, but undefined, uses not authorized by Congress, to which the government might some day put these properties. This question is a judicial one which this court must decide in performing its duty of enforcing the provisions of the Federal Constitution.

At page 7 of its brief the United States argues that *Cincinnati v. Vester* "rests on a narrow view of eminent domain under state law and does not apply to the exercise of the federal power." This is not true. It is true that in *Cincinnati v. Vester* the court had under consideration the power of a municipality to condemn private property under the authority of a municipal ordinance but the power to condemn was determined by the Supreme Court of the United States under the Fourteenth Amendment to the Constitution of the United States which contains the identical prohibition against depriving any person of property without due process of law that is contained in the Fifth Amendment. The Federal Government has no greater power to deprive a citizen of his property without due process of law than has a state or a municipality.

At pages 10 through 12 of its brief, the United States argues that there is a distinction between "public use" and "public purpose" and that *Cincinnati v. Vester* represents a narrow concept of public use as distinguished from public purpose frequently followed by state courts.

In support of this claimed distinction, the United States points out that in the later case of *Berman v. Parker,* 348 U.S. 26 (infra), the Supreme Court talks in terms of public purpose rather than public use. Appellee also points out that in the *Berman* case and in several other cases cited at page 12 of its brief, it was held that condemnation was proper even though the property condemned was to be maintained and operated by private individuals.

It is true that the *Berman* case spoke in terms of public purpose. This was true because that case involved the constitutionality of the statute in question rather than the actual taking. The court does not mention or discuss any such distinction as is urged by appellee and the decision itself, as well as all of the other decisions cited by the United States upon this subject, simply holds that where it is determined that the taking of private property is necessary for a public purpose, and that this purpose may be best served in private enterprise, such use is in effect a public use. This does not mean that the property can be taken for a use unrelated to the purpose to be accomplished under the statute or for a use other than that authorized by the statute or described in the declaration of taking. In every case cited by the United States upon the point, the property was taken to be used for the purpose authorized by the statute and was a public use even though the property was physically operated by private individuals.

In this connection it will be noted that the Fifth Amendment speaks in terms of "public use." The words "public purpose" are not used. It will also be noted that Title 40 USCA Section 257, which authorizes condemnation procedure in a case of this kind, permits condemnation *"for public uses"*. We also remind the court again that the Complaint in Condemnation filed by the United States Attorney at the direction of the Secretary of the Navy alleges the "public use" for which the property is sought to be taken. The Declaration of Taking Act, Title 40, USCA Section 258(a), which provides for the vest-

ing of title in the United States in lands acquired for a *"public use"*, requires that the Declaration of Taking shall state that the lands are taken for the *"use"* of the United States and shall contain "a statement of . . . the *'public use'* for which said lands are taken." None of these Acts speak of "public purpose". The "public use" alleged in the complaint is the establishment of Lemoore Naval Air Station.

A reading of the decisions cited by both the United States and Southern Pacific Land Company in their briefs will demonstrate that the courts for the most part have spoken of public purpose and public use interchangeably and without distinction, and that the distinction here sought to be made is a product of counsel's own thinking and not of any judicial pronouncement.

The United States cites *United States v. Welch,* 327 U.S. 546, as taking a contrary view to that taken in *Cincinnati v. Vester.* In the *Welch* case Mr. Justice Black in his opinion did discuss the *Cincinnati* case and did distinguish it on its facts but he did not overrule it, either expressly or by implication. Mr. Justice Black distinguished the *Cincinnati* case from the *Welch* case upon the ground that in the *Cincinnati* case the attempted taking was not for a use authorized by the statute while in the *Welch* case the taking was for a use authorized by the statute (p. 552). Mr. Justice Black's final comment on the power of the court to review even an act of Congress permitting the condemnation of property for a specific use was that "its decision is entitled to a *deference* until it is shown to involve an impossibility." There is a sig-

nificant difference between "deference" and "lack of jurisdiction."

In the *Welch* case the Tennessee Valley Authority condemned certain lands outside of the immediate area where the Tennessee Valley Project was being constructed. This was for the purpose of eliminating very costly road building to an area isolated by the project and was done upon a determination of necessity by the Tennessee Valley Authority after much study and negotiation with the State of North Carolina and other agencies involved.

The court *did review* the Tennessee Valley Authority Act and the facts which led to the decision of the Tennessee Valley Authority to take this particular property and *upon such review* and *under that Act and those facts* concluded that the Act was sufficiently broad to permit the taking of the properties in question upon a determination by the Authority that the taking was necessary to carry out the purposes of the Act. The court held that since the Authority in its discretion had made such a determination of necessity for a use authorized by the Act the court would not interfere with that determination. The court said:

> ". . . The T.V.A. had a dual interest. First, the isolated area, while not actually submerged by the reservoir, was a part of the watershed. Left in private hands it could be used to frustrate some of the objectives of T.V.A. legislation (p. 549) . . .
>
> ". . . Section 4(1) of the Act empowers the Authority to condemn certain specified types of

property and concludes by referring to 'all property that it (the Authority) deems necessary for carrying out the purposes of this Act.' To make clear beyond any doubt the T.V.A.'s broad power, Congress in Sec. 25, 16 USCA Sec. 831x, 5 FCA title 16, Sec. 831x authorized the Authority to file proceedings, such as the ones before us, 'for the acquisition by condemnation of any lands, easements, or rights of way which in the opinion of the corporation are necessary to carry out the provisions of this Act.

"'All of these provisions show a clear Congressional purpose to grant the Authority all the power need to acquire lands by purchase or by condemnation which it deems necessary for carrying out the Act's purposes.' These proceedings were preceded by a T.V.A. resolution that it did deem these acquisitions necessary for such purposes. (p. 554) . . .

"We think that it is the function of Congress to decide what type of taking is for a public use and that the agency authorized to do the taking may do so to the full extent of its statutory authority." (p. 552)

Mr. Justice Reed concurred in the decision but refused to join in the opinion because it might be construed as holding that "there is no judicial review of the Authority's determination that acquisition of these isolated pieces of private property is within the purposes of the TVA Act." Chief Justice Warren agreed with Mr. Justice Reed. Mr. Justice Frankfurter joined in the opinion of the court only upon the ground that he did not believe that it might be

construed as feared by Mr. Justice Reed. Mr. Justice Frankfurter stated his view as follows:

> ". . . This Court has never deviated from the view that under the Constitution a claim that a taking is not 'for public use' is open for judicial consideration, ultimately by this Court."

A reading of this case makes it entirely clear that the condemnation of the property in question was sustained only because it promoted the purposes of the Tennessee Valley Project and because the Tennessee Valley Authority in the exercise of its authorized discretion had determined that it did so. The court was not faced with a taking which in no way promoted the purpose of the project and which was insisted upon only because the governmental officer making the decision believed that the property might be of use to some other agency of the government in connection with some hypothetical purpose or project at some future time.

At numerous places in its brief the United States cites *Shoemaker v. United States,* 147 U.S. 282, and repeatedly says that the position taken by appellant in its opening brief and any statement made in any decision supporting that position is a departure or variation from the "Shoemaker rule". Again, this is not true. The *Shoemaker* case did not involve the act of a governmental officer or agency. It involved the constitutionality of an act of Congress authorizing the condemnation of lands for a public park in the District of Columbia. The issues there were in no way similar to the issues in the case at bar and the lan-

guage relied upon by appellee must be read and construed in the light of the issues there under consideration. The language cited by appellee is:

> "While the courts have power to determine whether the use for which private property is authorized by the legislature to be taken, is in fact a public use, yet if this question is decided in the affirmative, the judicial function is exhausted; . . ."

It will be noted that the court did recognize the jurisdiction of the court to review a statute to determine whether the use for which a taking is authorized is in fact a public use. However, the court was not concerned with and did not pass upon its power to review a taking by a governmental officer or agency for a purpose or use beyond the legislative authorization or to review a taking by a governmental officer which is in bad faith or which is arbitrary or capricious or unreasonable or in abuse of his discretion.

The case most heavily relied upon by the United States is *Berman v. Parker,* 348 U.S. 26. That was an action by the owners of real property to enjoin a condemnation pursuant to the District of Columbia Redevelopment Act of 1945. The Act authorized the Redevelopment Agency to acquire real property by eminent domain for the redevelopment of slum areas in the District of Columbia. The Agency attempted to take appellant's land upon which a department store was located. Appellant objected that this property could not be taken constitutionally because it was commercial and not residential property and did not constitute slum housing and because the Redevelop-

ment Agency intended to place the property under private management for private and not public use. The Supreme Court held that the Act was a proper exercise of the police power and was constitutional and that it was immaterial that the purposes of the Act were to be carried out by private enterprise. The court further held that it was within the authority of Congress to attack the problem on an area basis rather than by a structure basis. The court stated:

> ". . . *Once the question of the public purpose has been decided,* the amount and character of land to be taken for the project and *the need for a particular tract to complete the integrated plan* rests in the discretion of the legislative branch . . .
>
> "The District Court indicated grave doubts concerning the Agency's right to take full title to the land as distinguished from the objectionable buildings located on it. 117 F. Supp. 705, 715-719. We do not share those doubts. *If the Agency considers it necessary in carrying out the redevelopment project to take full title to the real property involved, it may do so.* It is not for the courts to *determine whether it is necessary for successful consummation of the project* that unsafe, unsightly, or unsanitary buildings alone be taken or whether title to the land be included, any more than it is the function of the courts to sort and choose among the various parcels selected for condemnation."

This case determines just two things: (1) that the Act of Congress under which the taking was authorized was constitutional as an exercise of the police power,

and (2) that when the agency created under the Act *exercised its discretion to determine that the use of the entire property was necessary to the successful consummation of the authorized project,* it was not for the court to question the soundness of *that exercise of discretion.* The court did not hold that it lacked jurisdiction to protect the property owner against the taking of his property where there had been no such exercise of discretion and no determination that the property was necessary for the consummation of the project, or would in fact be used for any purpose connected with the project.

At page 14 of its brief, the United States states that *Berman v. Parker* rejects the idea that the project may be pulled apart and each parcel treated separately in determining whether the taking is for a public use. In that case the Redevelopment Agency was attempting to redevelop an area. The court held that this was a proper exercise of its discretion and that when it was determined by the Redevelopment Agency that appellant's property was needed as a part of the redevelopment of the whole area, this was a public use authorized by the statute and appellant could not insist that his property be considered alone. In the case at bar Southern Pacific Land Company does not ask that any of its property determined to be necessary or advantageous to the purposes of the Air Base be considered separately from any other property sought for that use. Its only objection is to the taking of a separate estate in that land which cannot and does not in any way advance

those purposes. Southern Pacific Land Company does not ask the court to "pull the project apart" or that the court substitute its judgment for that of the Secretary of the Navy as to what is necessary for the establishment, maintenance and operation of Lemoore Naval Air Station. It simply asks that the court protect it against the taking of property rights which in this area are normally reserved from any sale of such lands (Rep. Tr. p. 60) and which the Secretary of the Navy himself says were not intended to be used and cannot and will not be used in furthering the purposes of Lemoore Naval Air Station.

At page 8 of its brief, the United States states that in *Berman v. Parker,* the Supreme Court modified the decision of the court below "to preclude court examination of alleged arbitrary or capricious administrative action." This statement is not accurate. In the court below (*Schneider v. District of Columbia,* 117 Fed. Supp. 705, at 725) it was pointed out that the issue of arbitrary and capricious action was not pleaded and therefore was not at issue. The Supreme Court did not refer to any claim of arbitrary or capricious conduct and did not pass or comment upon whether any such defense would be a proper matter for court review.

At page 26 of its brief the United States cites *United States v. Carmack,* 329 U.S. 230, as reversing a finding that the selection of a site for a post office was an "arbitrary and unnecessary act." The court did reverse a finding that the selection of the post office site was an "arbitrary and unnecessary act" but it did

so on the merits after a review of all the facts rather than upon lack of jurisdiction. In answer to the Government's position that the court lacked jurisdiction to review such a determination against a charge of bad faith or capricious or arbitrary action the court said:

> "In this case, it is unnecessary to determine whether or not this selection could have been set aside by the courts as unauthorized by Congress if the designated officials had acted in bad faith or so 'capriciously and arbitrarily' that their action was without adequate determining principle or was unreasoned. The record presents no such issue here." (p. 258)

B. The Decisions Of The Circuit Courts Of Appeals

In our opening brief we cited *Simmonds v. United States,* 199 Fed. 2d 305, which to our knowledge is the only decision in this Circuit passing upon this subject, wherein this court recognized the rule that the power of a governmental officer to take private property depends upon his determination in the exercise of his authorized discretion that the taking of the property is necessary or advantageous to the government for the use authorized; that before property is so taken it is the duty of the governmental officer to so exercise his discretion; and that his discretion so exercised is subject to attack if made in bad faith or is an abuse of that discretion.

This decision was followed in a subsequent decision in the Northern District of California, *United States v. 113.81 Acres of Land,* 24 Fed. Rules Decisions 368, wherein it was held on the authority of the *Simmonds*

case that such a defense may be raised by answer and is one which must be tried by the court.

The United States does not attempt to distinguish the *Simmonds* case except to state that it repeated a dictum and it concedes that other judges within the Ninth Circuit have taken the *Simmonds* case as authority for refusing to strike allegations of abuse of discretion.

At page 16 of its brief the United States cites the case of *United States v. State of South Dakota,* 212 Fed. 2d 14, decided in the Eighth Circuit, as holding that the taking of mineral rights in the condemnation of an airfield was not reviewable by the District Court. This case was also cited by Judge Crocker in a Memorandum Opinion as "impossible to distinguish." We must agree that superficially the facts of this case are closer to the facts in the case at bar than any other case cited. However, a closer analysis of the case will demonstrate not only that it is materially distinguishable but that the distinction is such as to clearly illustrate the real issue between the parties in the present case.

In the *South Dakota* case the United States sought to condemn real property in fee simple for the establishment of an Air Force Base. The State of South Dakota was the owner of the mineral rights and objected to the taking upon the ground that the acquisition of such mineral rights by the United States was not necessary for the authorized public use. The court reversed the judgment of the District Court dismissing the action as against South Dakota

upon the ground that the Secretary of the Army in his discretion had determined that the taking of the mineral rights was necessary for the purpose for which the land was sought (the establishment of the air base) and that such exercise of discretion was not reviewable.

In that case the act of Congress authorizing the condemnation expressly and explicitly authorized the Secretary of the Army to *condemn the title in fee simple.* There is no such specific authorization in the case at bar. The only authorization found in Public Law 968 authorizing the establishment of the Lemoore Naval Air Station is to acquire "property" and the only authorization found in Title 40 USCA Section 257 permitting condemnation procedure for this purpose is to acquire "real estate". Thus, in the *South Dakota* case, as distinguished from the present case, the Secretary of the Army was complying with the express language of the statute in acquiring the entire fee title.

Moreover, in the *South Dakota* case the issue on appeal was submitted upon the pleadings and Declaration of Taking and without further evidence. On the basis of the complaint and the Declaration of Taking the Circuit Court assumed that the Secretary of the Army had made a determination that the taking of the mineral rights was necessary for the purposes of the air base. In the absence of evidence to the contrary and since it was the duty of the Secretary of the Army to make such a determination before filing the Complaint in Condemnation and the Declaration of

Taking, this was a proper assumption. In this connection, it should be noted that there was no pleading or claim of bad faith or of arbitrary or capricious action on the part of the Secretary of the Army. These defenses were not put at issue by the pleadings and were not considered nor mentioned by the Circuit Court. Thus, the case can be of little assistance here where defendant's answer did put these defenses at issue and where the Secretary of the Navy testified as he did here.

As page 23 of its brief the United States cites *United States v. Mischke,* 285 Fed. 2d 628, also decided in the Eighth Circuit. In that case land was condemned for the purpose of constructing a dam for flood control. The Complaint in Condemnation, the Declaration of Taking signed by the Secretary of the Army, and a letter from the Secretary of the Army asking that the Attorney General take action to condemn, all indicated that the Secretary of the Army had in his discretion determined that all of the land in question was "necessary and advantageous for use in connection with the construction and operation of the Gavins Point Dam and Reservoir Project." There was no evidence such as was presented in the case at bar showing that he had not exercised such discretion and had not made such determination. The defendant objected to a portion of the taking which consisted of land adjoining the reservoir and the Government introduced evidence at the trial that this land was needed for use as a means of access to the reservoir, as well as a place for the parking of cars and the

launching of boats by persons visiting the reservoir for purposes of recreation. The District Court held that the taking of the excess lands was arbitrary and capricious and ordered that these lands be revested in the defendants. The Circuit Court reversed this judgment.

In this case it was clear that the Secretary of the Army did exercise his discretion and did determine that the taking was necessary for or at least advantageous to the use authorized by Congress and the United States produced evidence to substantiate such determination. Upon the basis of conflicting evidence presented by the defendants the District Court found that the taking of the excess lands was not necessary for that purpose and would not be used for that purpose and his determination to this effect was arbitrary and capricious. Upon this conflicting record the Circuit Court rejected the defense stating that such determination by the Secretary of the Army was not subject to review and that the District Court was without jurisdiction to enter the order appealed from. However, in so holding the Circuit Court conceded that there were cases in other jurisdictions, including the Ninth Circuit, from which a contrary decision might be reached.

We submit that both the *South Dakota* case and the *Mischke* case must be distinguished from the case at bar upon the ground that in both cases the court had under consideration a decision by an administrative officer that all the estate condemned was necessary for the purpose authorized while in the case at bar the

Secretary of the Navy by his own testimony made no such determination and intended the contrary. We further submit that if there is a conflict between the rule in the Eighth Circuit and the Ninth Circuit and/or other Circuits concerning the court's jurisdiction to pass upon the good faith of a governmental officer where he does make such a determination of necessity, and it is alleged that such determination is arbitrary, capricious or unreasonable, then that conflict should be resolved so as to protect the property owner. We cannot believe that the courts are entirely powerless to protect a property owner against the taking of his property when such taking is in excess of authority and/or is in bad faith, or is arbitrary or capricious. It may be true as stated in some of the cases that restraint should be shown in exercising such jurisdiction, but we believe jurisdiction does exist and should be exercised in a proper case.

At page 11 of its brief, the United States cites *Arp v. United States,* 244 Fed. 2d 571. The governmental officer involved, the Public Housing Commissioner, sought to condemn the fee title in land it already had under lease after having made a determination that "the acquisition of the fee simple title was necessary to continue in use housing constructed on the lands in the orderly demobilization of the war effort, to maintain the improvements constructed thereon, and to protect the Government's interest in the improvements." The defendant alleged that the taking of the fee was not necessary and that the Commissioner's determination was arbitrary and in bad faith. The

Circuit Court held that the defense was properly stricken *because it was "without merit" under the facts there presented and under the particular provisions of the Housing Act there involved which expressly gave the Housing Commissioner the right to make such a determination of necessity and upon such determination to file a supplemental complaint to obtain fee title to lands so held under lease.* The court did not hold that it lacked jurisdiction to review the decision and it did review it.

At page 15 of its brief the United States cites *Wilson v. United States,* a case decided in the Tenth Circuit on September 1, 1965. This case is particularly interesting because it is referred to by the United States as the most recent decision on the subject. In a footnote on page 22 the United States says that the opinion is as yet unreported and that copies will be filed with appellee's brief and delivered to appellant's counsel. Apparently, this has not yet been done. In this case the United States condemned property for the construction of a dam and reservoir. *In so doing it sought to acquire a fee simple title to the land but did exactly what appellant seeks to have done in the case at bar, to wit: reserved to the landowners the gas and oil rights upon condition that gas and oil could be prospected for and removed only under regulations imposed by the Secretary of the Interior.* Thus the question of oil, gas and mineral rights was not at issue. However, the landowners objected that the government sought to condemn more surface rights than was necessary for reservoir purposes. The Solicitor of

the Department of the Interior *had determined that all of the lands in question were necessary and would be used in connection with the project,* and the Circuit Court held that this determination was within the discretion given to him under the statute there involved. However, the defendants claimed that in making this determination the Solicitor acted in bad faith and was arbitrary and capricious in including more lands than were actually necessary.

Again, the Circuit Court did not deny jurisdiction although it determined this defense against defendants *on the merits,* concluding that there was no proof of bad faith or of arbitrary action. In so holding, the court recognized, at least by implication, its jurisdiction to look at the facts for the purpose of determining whether the solicitor's discretion was exercised in good faith and whether or not his decision was arbitrary or capricious. The court pointed out that in this case the government had simply taken advantage of established boundary lines rather than making a new survey and that this was reasonable to avoid the expense involved in establishing new boundaries. The court held that this was a reasonable "determining principle" for the solicitor to take into consideration and this being true, the fact that in so fixing the boundaries more land was taken than was absolutely necessary for the basic public use did not taint the taking with bad faith or arbitrariness or capriciousness. The court said:

> "... *In the absence of bad faith,* and bad faith is not demonstrated here, if the use is a public one,

the necessity for the desired property as a part thereof is not a question for judicial determination.

"In the ordinary sense of the meaning of the word 'arbitrary', it may be said that there has been an excessive arbitrary taking in this case. However, it falls within an 'authorized' or 'licensed' arbitrariness *because it is made with some determining principle.* Considering the nature of the lands taken and possible subsequent uses for the lands, it is reasonable to avoid the expense involved in establishing new boundaries following contour lines that would be established at maximum water elevation to the reservoir. *Under such circumstances,* the so-called arbitrary taking is within the authorized discretion of the federal officer involved and is not *in this instance* tainted with bad faith or capriciousness. We must find that there is *no merit* to the landowners' points. . . .

"From a review of the whole record it appears that the trial court committed no substantial error. . . ."

It is clear that the defenses of bad faith and of arbitrary and capricious action in this case were decided on the merits and that the case is no authority for the position of the United States in the case at bar that the court has no jurisdiction to determine such a defense.

At pages 8 and 17 of its brief the United States cites the decision of this court in *United States v. Cobb,* 328 Fed. 2d 115. That case is not authority for the position of the United States in the case at bar.

There, the United States in filing a Declaration of Taking estimated the amount of damage or value to be $1.00. The District Court ordered the Declaration of Taking set aside and vacated upon the ground that the estimate was not made in good faith. This court reversed the order. Obviously, the questions involved in the case at bar were not involved in the *Cobb* case. The fixing of the amount of the deposit was simply a part of the *procedure* by which the defendant would finally obtain just compensation which by the express language of the Declaration of Taking Act is left to the discretion of the condemning agency. The court pointed out that it is not required that the government make any deposit and neither the amount of the deposit nor the making of the deposit ultimately determines what property is to be taken or the amount of the just compensation to be paid to the defendant. The defendant's constitutional rights were in no way involved. Thus, this court correctly held that it would not interfere with the discretion of the condemning agency. This is no authority in the case at bar which involves the right of the United States to take property it is not authorized to take and does not intend to use for the purpose authorized and which involves the fundamental property rights of the defendant as protected by the Constitution and the Fifth Amendment. The basis for the decision in the *Cobb* case was as follows:

> "In the first place, the administrative officials have been delegated the authority to make the declaration of taking and to make the estimate . . .

"The main objection to permitting the Judge to go into the question of good faith is that he thereby could do what he clearly is not authorized to do, namely, pass upon the appropriate amount of deposit . . .

"Of course, it is elementary that the Government could take the property without any deposit and leave the owner to his remedy in the Court of Claims under the Tucker Act. United States v. Dow, 357 U.S. 17, 21, 78 S.Ct. 1039, 2 L.Ed. 2d 1109. That on occasions a nominal sum such as $1.00 may properly be deposited is plain."

It is significant that in reaching this decision the court did not feel required to mention or refer to the *Simmonds* case or any other case cited in these briefs.

III

ANSWER TO MISCELLANEOUS ARGUMENTS MADE IN APPELLEE'S BRIEF

At page 4 of its brief the United States says that defendant's answer seeks to limit the estate taken by reserving minerals including oil and gas. The United States is entitled to state the effect of defendant's answer in words it chooses to use. However, Southern Pacific Land Company wishes to state its position differently. The mineral rights constitute a separate, severable estate in the land. Southern Pacific Land Company did not contest the taking of the surface rights because those rights were necessary and were to be used for the establishment of the Air Station. It did contest the taking of the mineral rights because those rights could not and were not intended to be used for the purposes of the Air Station. Southern Pacific Land Company does not seek to limit the extent of the estate determined by the Secretary of the Navy to be necessary for the purpose authorized. It does seek to prevent the taking of an estate as to which no such determination was made or could be made.

At page 6 of its brief the United States refers to the fact that Judge Crocker filed a memorandum decision in which he stated that he found no evidence to support the allegation that the Assistant Secretary of the Navy acted in bad faith or arbitrarily or capriciously. However, the memorandum decision was superseded by complete and detailed findings of fact placing his decision entirely on the premise that he had no jurisdiction to review the determination of the Assistant Secretary of the Navy or to pass upon the

defense that the taking was in bad faith or arbitrary or capricious. Consistent with this holding, no finding was made upon this defense. Since Judge Crocker's actual conclusion was that he had no jurisdiction to consider the testimony of Mr. Bantz, it is clear that the statement made in his memorandum was not based upon any real consideration of that testimony.

At page 7 of its brief the United States argues that the cost of a federal project is relevant to its decision to take and that the eminent domain power can be used to recoup investments or to avoid undue expense. Assuming this to be true, it has no application here. No property right can be taken without just compensation. Obviously, the cost of the project with the oil, gas and mineral rights would be more than its cost without those rights. It does not avoid undue expense to take property that is not needed for the project.

At page 9 of its brief the United States seems to concede that a court has power to review an administrative determination on account of alleged bad faith but questions that power for arbitrary or capricious action. It is argued that if the rule were otherwise the issue simply becomes one of weighing the factors for and against the administrative decision. The United States says "this is not the court's business." To begin with, we disagree with the premise that in determining arbitrary or capricious action the issue amounts to no more than a weighing of the factors for and against the administrative decision. A determination that such a decision was arbitrary or capricious would entail more than a weighing of such factors and more than

disagreement with the decision on the part of the court. However, in the case at bar it is not necessary to reach an exact definition of what is meant by arbitrary or capricious action. Where a governmental officer decides to take private property knowing that its use is completely incompatible with the use for which he is authorized to take the property, and testifies that the United States had no intention of using the property for that purpose, and attempts to justify his decision solely upon the ground that there is no limitation upon his power to take, that the court has no jurisdiction to protect the landowner, and that it is no business of the court, his conduct in so doing is an abuse of his discretion whether such abuse is described in terms of bad faith or arbitrary or capricious conduct or otherwise. We believe that it is the court's business to protect every landowner against such action and to assure to every landowner the protection to property rights guaranteed by the Constitution.

At page 9 of its brief the United States says it is sure Southern Pacific Land Company will not challenge the Constitutional power of Congress to establish a naval air station. This is true. It then says that the statutory authority of the Navy Department to acquire land needed for the purposes of Lemoore Station is equally clear. This is also true. However, it does not follow that the Navy Department has authority to acquire an estate in the land which is a separate estate and is concededly not needed for the purposes of the Naval Air Station, or that the court is without jurisdiction to prevent such a taking.

At pages 21 to 26 of its brief the United States discusses some of the conflicting decisions concerned with the power of a Federal Court to review a taking alleged to be in bad faith or arbitrary, capricious or in abuse of discretion. It is argued that any recognition of a right of review in these cases ignores the rule of the *Shoemaker* case and amounts to nothing but "unconsidered dictum". The United States includes in this category the decision of this court in the *Simmonds* case. Most of these decisions have been discussed elsewhere and it will be noted that those courts recognizing such power to review do so on various grounds. Some speak of bad faith and seem to limit the power of review to cases of bad faith. Others speak of arbitrary or capricious action. Others speak in terms of abuse of discretion. Others use such terms as "unreasonable" or "impossible". The principle is the same whatever language is used to describe it. We again submit that the action of the Assistant Secretary of the Navy in this case is in bad faith *and* is arbitrary, capricious and unreasonable *and* is an abuse of his discretion. As such, it is subject to review regardless of what terminology the court chooses to use in so holding.

At page 17 and again at page 22 of its brief, the United States argues that bad faith must be limited to personal wrong-doing on the part of governmental officer involving "bribery, corruption, personal malevolence or dereliction of duty in the nature of a fraud or some personal interest or sinister motive." To this effect the United States cites a decision of the District

Court of the Northern District of Illinois, *United States v. 40.75 Acres of Land,* 76 Fed. Supp. 239. In that case the defendants alleged bad faith. They did not allege arbitrary or capricious action or abuse of discretion in those terms. Therefore, the court talked only in terms of "bad faith" and did suggest that bad faith meant actual malevolence toward the defendants *unless the taking was for a use not authorized by the statute.* Of course, it is this last conception of bad faith that is the essence of appellant's position in the case at bar. The court stated:

> ". . . *If a taking is for a use not authorized by statute, as the contention was made in the Barnidge case, it may be said to be a taking in bad faith.*
>
> * * *
>
> "None of the foregoing cases, however, is explicit as to the meaning of bad faith. In the law of torts bad faith can mean either the mere lack of legal excuse or an actual malevolent purpose. As a restraint on the power of eminent domain, *apart from the public use inquiry which goes to the lack of legal excuse for the taking,* I think that bad faith means actual malevolence toward the complaining defendants . . ."

We do not agree with the thinking of the Illinois court that bad faith should in any event be limited to actual malevolent conduct toward a defendant. Bad faith can take on many forms and no good reason was advanced for giving it such a narrow meaning. However, we do agree with the limitation placed upon that meaning where private property is taken for a use not au-

thorized by the statute. Such a taking is not only within any reasonable definition of bad faith but may also be described as arbitrary and capricious and in abuse of whatever discretion is placed in the condemning agent.

At page 27 of its brief, the United States cites *United States v. Merchants Transfer and Storage Co.*, 144 Fed. 2d 324, decided by this court, as stating that "In essence, while protesting the contrary, the (lower) court substituted its judgment on the question of *public necessity* for that of the Secretary." This quotation illustrates the point we are attempting to make. The court will not substitute its judgment on the question of *public necessity*. It will reverse an arbitrary decision to take property where no such determination of public necessity for the use authorized by the statute was made and where it is conceded that none exists.

Again at page 28 of its brief the United States insists that inevitably the review process leads the court into engineering matters or other matters not suited for determination according to the adversary process of litigation. The United States argues that for this reason the decision should be left to those to whose judgment Congress entrusted it. If in the case at bar the Secretary of the Navy had made a determination upon engineering or other expert advice that the taking or use of these oil, gas and mineral rights was necessary or advantageous to the United States in the establishment or operation of Lemoore Naval Air Station, this court would be faced with a different

question. It is clear that this was not and is not the situation here involved.

At page 28 of its brief the United States argues that it must take appellant's oil, gas and mineral rights because other landowners whose lands are taken for the Lemoore Naval Air Station must receive equal treatment and it is unlikely that all other landowners would be willing to defer exploration or production during the existence of the air base. It is argued that in such case such owners would probably demand the full present market value of the mineral rights, despite the reservation. Obviously, this argument has no merit. Unless a landowner voluntarily agreed to defer exploration and production, it would of course be *necessary* to condemn the mineral rights. This would be a use directly connected with the establishment of the air base. Likewise, if any property owner claimed additional compensation because his right to explore or produce was deferred it would then be a matter of administrative discretion to determine whether it would be advantageous to the government to take the mineral rights or pay the additional compensation. However, Southern Pacific Land Company did voluntarily offer to defer exploration and production and did not seek additional compensation because thereof and equal treatment to all is accomplished if equal treatment is given to all who stand in this same position.

At page 29 of its brief the United States again argues that if the public is to pay for the mineral rights, because of its interference with the landowners

ability to extract the minerals, it should obtain title to the rights so as to secure such values as they may have in the future. We repeat that Southern Pacific Land Company has never asked for compensation for the deferment of its present ability to extract the minerals, and it did not in its pleadings or at the trial pray for any such compensation or suggest that it should be so compensated. It has always offered to defer its right to extract minerals without compensation so long as a Naval Air Station remains on the property, and its only insistence is that it is entitled to retain those rights for whatever they may be worth if and when the air base may be abandoned. The court will note the stipulation of the parties provides that the amount fixed by such stipulation as just compensation for the taking is by way of compromise and settlement of the issue of just compensation alone and that in determining other issues in the case it will not be presumed nor inferred that said sum does or does not include any amount as the fair market value of the mineral rights and that neither the said stipulation nor the award of said amount as just compensation shall be considered by the court in any way in making any determination of whether the United States is or is not entitled to the mineral rights or whether the mineral rights shall be reserved to the defendant owner or what conditions or limitations shall be placed upon said reservation. (Tr. of Rec. pp. 715-716).

At page 29 of its brief the United States argues that when once it has taken property for a specific use, the

title is not limited to that use and that it is not impossible that in the future this land might be converted to another federal use not incompatible with mineral extraction. This is what Mr. Bantz testified he had in mind when he made the decision to take the mineral rights. It is true that if the oil, gas and mineral rights were taken for some military or naval use connected with the operation of Lemoore Naval Air Station, and the Naval Air Station were thereafter abandoned without those rights having been exhausted, the oil, gas or other minerals would be available for another public use. Any such future use would be incidental to the authorized use for which the property was taken. However, it does not follow that Mr. Bantz was authorized to take the mineral rights for any such hypothetical future use by "another federal agency" without any initial intent to use them for the purposes of Lemoore Naval Air Station.

At pages 29 and 30 of its brief the United States argues that because all of the property taken will not be used for runways a review of the secretary's decision to take would inject the court into engineering details concerned with the planning and operation of the air station. This is not true. We ask only that the court accept the testimony of Mr. Bantz (and the other government witnesses who were subpenaed and testified) that the extraction of oil, gas or other minerals from the property during the life of the air station would be completely incompatible with its use as an air base, and that the Department of the Navy did not have and has no intention of extracting or

using such oil, gas or other minerals. This does not inject the court into any of the engineering details of planning or operations or otherwise.

Finally, at page 30 of its brief the United States objects to the form of the reservation of oil, gas and mineral rights suggested in appellant's opening brief because it was never considered or reviewed by the District Court and because the District Court did not make findings in respect thereto. A reservation to this effect was offered in defendant's answer and at the trial of the action defendant offered to arrive at a form of reservation satisfactory to the United States or to permit the court itself to draft such a reservation (Tr. of Rec. p. 361; R. Tr. p. 157). These offers were repeated in appellant's opening brief (p. 38). The United States rejected all these offers and refused to discuss them. At the trial the United States refused to cross examine defendant's witnesses or to produce evidence of its own and chose to rely entirely upon its claim that the court had no jurisdiction. Thus, the testimony of defendant's witnesses is uncontradicted in the record. The District Court failed to make findings in accord with their testimony or in reference to the proposed reservation only because it accepted appellee's contention that it had no jurisdiction to do so. The United States is not now in a position to complain because there was no further evidence upon the subject or of the failure of the District Court to make a finding upon the subject, and this court may enter judgment as requested in Appellant's Opening Brief (See pages 35 to 42).

In a footnote at page 30 of its brief the United States takes issue with appellant's claim that the mineral rights constitute a separate estate in the land and in so doing criticizes *United States v. 4.553 Acres of Land, etc.,* 208 Fed. Supp. 127 (N.D. Cal. 1962) cited by appellant at page 22 of its opening brief. The United States points to the fact that where mineral rights are taken the entire estate in the land including the surface rights and mineral rights must be valued as a whole in a condemnation award and that the estate taken must be controlled by federal law. In a general sense this is true insofar as it involves matters of procedure in the Federal Courts or rights under the Federal Constitution or Federal Law, but it is not true insofar as it purports to involve a determination of the character and incidents of property rights in California (*United States v. Certain Properties,* 306 Fed. 2d 439 at 444). We believe it almost elementary that a fee simple title may include severable estates in the land and the fact that the United States seeks to condemn all those estates does not mean that it is entitled to do so under the facts here presented. We again remind the court that in *Wilson v. United States,* supra, cited by the United States as the most recent decision on the subject, the United States treated the oil, gas and mineral rights as a separate estate in the land and voluntarily reserved them to the landowners althought the declaration of taking and the complaint in condemnation described the taking it sought as a "fee simple title". The court described the estate sought to be taken as follows:

"The interest in the lands sought to be acquired was a fee simple title excepting and reserving therefrom gas and oil which may be prospected for and removed under regulations imposed by the Secretary of the Interior . . ."

Appellant respectfully urges the court to enter judgment as prayed for in appellant's opening brief.

Dated, Fresno, California,
December 9, 1965.

Respectfully submitted,
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CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

GALEN MCKNIGHT,
Attorney for Appellant.

No. 19,882

In the

United States Court of Appeals

For the Ninth Circuit

SOUTHERN PACIFIC LAND COMPANY,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

Appellant's Petition for Rehearing

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SOUTHERN PACIFIC LAND COMPANY,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

Appellant's Petition for Rehearing

To the Honorable Frederick G. Hamley, James R. Browning, and Ben. C. Duniway, Circuit Judges:

Appellant Southern Pacific Land Company respectfully requests a rehearing in this case upon the following grounds:

I. The United States, Southern Pacific Land Company, and All Citizens Who Own Property Subject to Condemnation Are Entitled to a Decision on the Jurisdiction of the Court to Review a Taking Alleged to Be in Bad Faith, Arbitrary, Capricious or an Abuse of Discretion

In its decision filed herein this court refused to pass upon the jurisdiction of the District Court or this court to determine whether or not the taking of appellant's oil, gas and mineral rights was in bad faith or capricious or arbitrary.

From the very beginning the United States has relied entirely upon its position that the declaration of taking was final and that

the court had no jurisdiction to review that taking. The importance it placed upon obtaining a judicial determination to this effect is illustrated by the fact that it stipulated to a judgment fixing the fair market value of the property taken at $1,250,000.00 regardless of whether or not it finally obtained the oil, gas and mineral rights. The stipulation expressly left open for judicial determination the question of the finality of the taking of those rights.

At the trial the United States chose to rely entirely upon lack of jurisdiction and refused to cross examine any of defendant's witnesses or to present any evidence on its own behalf. It considered the importance of obtaining a final decision on this question so great that it was willing to risk losing the oil, gas and mineral rights which were valued, according to the undisputed testimony, at over a quarter of a million dollars.

At the hearing on appeal, the Assistant United States Attorney stated in open court that in the event the question of jurisdiction was determined against him he did not wish the case to be remanded for retrial or further evidence in the District Court.

Southern Pacific Land Company was equally anxious to have a decision in its favor upon this question. It also stipulated to the fair market value of the whole property, leaving open the question of the court's jurisdiction, thereby taking the risk of losing the oil, gas and mineral rights without further compensation.

The District Court joined with the parties in this effort to obtain a clearcut decision on jurisdiction. Its judgment was based entirely upon an express written finding that it did not have jurisdiction. It made no finding upon whether the Assistant Secretary of the Navy acted in good faith or whether he acted arbitrarily or capriciously or in abuse of his discretion.

The reason the parties and the trial court placed so much importance on the final answer to this question is clear. The United States is faced with the question every time it makes a decision to take property. Every owner of land is faced with it when and if he seeks to resist a taking of his land. The number

of decisions upon the subject and the conflict in those decisions demonstrate the unsatisfactory state of the law.

The parties have done everything possible for them to do to obtain such a determination. The District Court has done likewise. This court now has the problem directly before it. We respectfully ask that the court grant a rehearing and determine the question.

II. This Court Erred in Stating That the District Court Held That There Was No Evidence to Support the Allegation of Bad Faith or Arbitrary or Capricious Conduct

The statement of this court here referred to is based upon the District Judge's memorandum opinion. This court says that it may properly consider that memorandum opinion as a part of the findings *if it is consistent with formal findings,* serving merely to supplement them. This statement answers itself. The actual finding of the court was that it had "no jurisdiction to review or interfere with the determination of the Assistant Secretary of the Navy." If the court had no such jurisdiction it had no jurisdiction or power to find that the Assistant Secretary of the Navy did or did not act in bad faith or arbitrarily or capriciously. Clearly such finding, whether contained in the memorandum opinion or in the findings themselves, would be completely inconsistent with the finding that it had no jurisdiction to review the Secretary's decision.

III. In the Absence of Jurisdiction to Review the Decision of the Assistant Secretary of the Navy This Court Cannot Find That the Evidence Does Not Support the Allegations of Bad Faith or Arbitrary or Capricious Conduct

Again, this statement speaks for itself. It would seem completely clear that until this court decides that it has jurisdiction to review the decision of the Assistant Secretary of the Navy to take defendant's oil, gas and mineral rights it cannot determine that the Assistant Secretary's decision was not in bad faith or arbitrary or capricious.

IV. This Court's Statement That It Was the Uncontradicted Testimony of the Assistant Secretary of the Navy That Failure to Take the Mineral Rights Would "Reduce the Marketability of the Property in the Event of Sale" Is Not Accurate

The testimony upon which the court's statement is based is found at pages 127 and 128 of the Reporter's Transcript. That testimony did not amount to positive evidence based upon any purported knowledge of the Assistant Secretary that this would be the result. He simply *assumed* that owning the mineral rights along with the surface rights might make the property "that much easier to sell". Such an assumption does not amount to evidence.

Certainly, it cannot be said that this statement was uncontradicted. The only actual evidence upon the subject is found in the testimony of Mr. Kenneth R. Evans, who appraised the properties for the purpose of this lawsuit. Mr. Evans testified that out of 37 transfers of property in the area investigated by him the mineral rights had been severed from the remainder of the estate by reservations in all but five small parcels (Rep. Tr. p. 60). These were normal sales in the ordinary course of business, not condemnation sales. The only reasonable inference is that in this locality the property sells easier where the mineral rights are severed. Until and unless the mineral rights are developed these properties sell as farm land and they sell easier without the mineral rights because the price is less.

This court states that the government is not required to proceed oblivious to elements of cost. The element of cost favors the severance of the mineral rights from the surface rights. It would seem obvious that the fair market value of the property would be less if it did not include the mineral rights.

The oil, gas and mineral rights under these lands belong to Southern Pacific Land Company. It wants to keep them. The United States cannot use them and does not intend to use them for any use authorized by the statutes. While the Secretary of the Navy should be given wide latitude in the exercise of his discretion he should not be permitted to take private property on the basis of a vague, speculative assumption, unsupported by any

evidence, which would at the most go to the *convenience* of making a resale at some remote and undetermined time in the future. No claim is made that it would affect the price at which the property might be resold. We submit that to take mineral rights upon this basis is in bad faith and is arbitrary, capricious and an abuse of discretion.

Southern Pacific Land Company respectfully requests a rehearing.

Respectfully submitted,

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CERTIFICATION

I certify that the foregoing petition, in my judgment, is well founded, and that the same is not interposed for delay.

ROY JEROME
Of Counsel for Above Named Appellant.

No. 19922

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

KAMEN & CO., EDWARD F. LIEBERT, ABRAHAM KAMEN, *et al.*,

Appellants/Cross-Appellees,

vs.

PAUL H. ASCHKAR & COMPANY,

Appellee/Cross-Appellant.

APPELLEE'S BRIEF.

See also Vol. 3346

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No. 19922

IN THE

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Appellants/Cross-Appellees,

vs.

PAUL H. ASCHKAR & COMPANY,

Appellee/Cross-Appellant.

APPELLEES' BRIEF.

Statement of the Case.

A. Facts.

Appellee, Paul H. Aschkar and Company, is an over-the-counter broker-dealer with its sole place of business in Los Angeles. An over-the-counter broker-dealer purchases and sells securities not listed on any national exchange, either for its own account or for customers.

Appellant, Kamen & Co., is a limited partnership engaged in the securities business with its principal place of business in New York. Kamen & Co. is a member of both the New York Stock Exchange and the American Stock Exchange. The other defendants are general partners of Kamen & Co. and employees of Kamen & Co.

Over-the-counter broker-dealers often receive orders from their customers to purchase stocks listed on national exchanges (henceforth listed business). [R. T. 7.] The over-the-counter broker-dealer must execute such orders through a member of the exchange (henceforth listed broker) listing the particular security being purchased or sold. Under the rules of many exchanges the listed broker must receive the full commission fixed by the exchange for the execution of such orders. The over-the-counter broker-dealer places these orders for his customer free of charge as a service to his customers. [R. T. 7-8.] Since the price of the security is determined on the exchange and not by the member of the exchange who executes the order, it makes no difference to the customer which listed broker is used as long as such member executes the order promptly. There is fierce competition by members of national exchanges for the listed business of non-member broker-dealers. Since the rules of the New York Stock Exchange and some other exchanges prohibit commission splitting with non-members, the listed houses have customarily provided reciprocal business to over-the-counter dealers to induce them to place their listed business with them. [R. T. 12; see also: Argument III, *infra* and Report of Special Study of Securities Market of the Securities and Exchange Commission, excerpts from Part 2 and 4 of such report are attached to this brief as Appendix A.] Such reciprocal business takes many forms. One form is for the listed house to "give up" an over-the-counter trade that it could otherwise execute thereby giving the profit from that trade to the non-member broker. [R. T. 8-9, Appendix A, pp. 302 and 304.] The custom of reciprocal business has the approval of the New York Stock Exchange. (Appx. A, pp. 302, 304.)

On July 10, 1963, Mr. Aschkar received a call from Kamen & Co. [R. T. 15.] The caller solicited Paul H. Aschkar & Co.'s listed business and promised to direct over-the-counter business to Paul H. Aschkar & Co. In the same conversation the caller "gave up" to Paul H. Aschkar & Co. the name of a prospective purchaser and prospective seller of 700 shares of Jerome, Richard & Co., Inc., stock, an over-the-counter security. Frederick Cirlin & Associates, Inc., a broker-dealer located in New York, was supposedly interested in selling 700 shares of such stock at $19.25 per share and McNeel & Co., a broker-dealer located in Atlanta, Georgia, was supposedly interested in purchasing such shares for $19.375 per share. [Find. 25; R. T. 15, 16.] To complete the transaction and earn the $87.50 gross profit, Paul H. Aschkar & Co. was required to render the following services:

1. Write up a confirmation slip for the proposed seller and purchaser [Pl. Ex. 1 and 2];
2. Mail such confirmation slip to the seller and purchaser;
3. Receive confirmation from the seller and purchaser [Pl. Ex. 3 and 4];
4. Receive the security from the seller;
5. Pay for the security;
6. Mail such security to the purchaser;
7. Receive payment for the security.

The foregoing services are often referred to as execution and clearance services. (See Appx. A, p. 302.)

The day after the July 10 telephone call, Paul H. Aschkar & Co. received a letter from Kamen & Co.

including a business card of Ross describing him as the manager of the broker-dealer division of Kamen & Co. Kamen & Co. expressly authorized Ross to use such card and had the card printed for him. [Find. 16.]

On July 17, 1963, Kamen & Co. again telephoned Paul H. Aschkar & Co. from New York City and instructed it to execute the following transactions:

> Buy 1000 shares of Jerome, Richard & Co., Inc. common stock from Frederick Cirlin & Associates, Inc. for $19.25 per share and sell such 1000 shares to Handley Investment Company, a company engaged in the business of buying and selling securities located in Tulsa, Oklahoma, for $19.50 per share. This transaction was confirmed by all parties to the transaction. Prior to the delivery of the stock, however, the fraud subsequently described was discovered and Appellee suffered no loss as a result of this transaction.

The foregoing order was placed by Lawrence H. Ross the manager of Kamen & Co.'s over-the-counter broker-dealer division. On the same date Ross again phoned Paul H. Aschkar & Co. and placed a second order as follows:

> Buy 600 shares of Jerome, Richard & Co., Inc. common stock from Guss and Stead Company, a company engaged in the business of buying and selling securities, located in Salt Lake City, Utah, for $19.00 per share and sell such 600 shares to Frederick Cirlin & Associates, Inc. for $19.125 per share. [Finds. 27, 28; R. T. 27, 28.]

During the period of July 10 to July 17, Paul H. Aschkar & Co. placed certain orders for listed business

by calling the telephone number given to it by the employees of Kamen & Co. Kamen & Co. sent written confirmations of such orders to Paul H. Aschkar & Co. and executed such orders on the American Stock Exchange. Kamen & Co. took no risk in executing such orders. The buyer or seller, as the case may be, was furnished by Paul H. Aschkar & Co. and the other party to the transaction was furnished by the Stock Exchange. Kamen & Co. did not even perform the confirmation, shipping and payment service necessary to clear such stock, since such services were furnished to Kamen & Co. by Carl M. Loeb, Rhoades & Co., a large listed broker-dealer with whom Kamen & Co. split its commission in return for such services. Kamen & Co. received $166.00 in commissions for executing such orders. Kamen & Co. has never offered to return these commissions.

In order to give up substantial reciprocal business, the listed broker must have a large volume of over-the-counter business. Kamen & Co. had very little over-the-counter business. [R. T. 258.] Unknown to Paul H. Aschkar and the other defrauded broker-dealers, the reciprocal over-the-counter business "given up" by Kamen & Co. was fraudulently created by Lawrence Ross, the head of Kamen & Co.'s Broker-Dealer Division, and by other employees of Kamen & Co. [Finds. 18 and 25.]

Thus, Ross, Grossinger, and other employees would phone a broker-dealer (hence B) and ask B to purchase Jerome, Richard & Co., Inc. stock from A (another broker-dealer) at X Dollars and to sell it to C at X+ 1/8 Dollars. Unknown to B, C would be induced to purchase from B by another phone call asking him to

purchase from B at X+ ⅛ Dollars and to sell to D at X+ ¼ Dollars, and so on in a long chain, until the bubble finally burst. [Find. 18.] Hundreds of broker-dealers were defrauded in this manner. [Pl. Ex. 52 not admitted into evidence.] Ross and the other employees of Kamen & Co. made these calls by the use of special Wide Area Telephone Service installed by Kamen & Co. for Ross at Ross' request. [Find. 15.]

On July 23, 1964, Paul H. Aschkar & Co. paid a total of $24,875 for the 700 shares purchased on July 10, 1963 and the 600 shares purchased on July 17. The fraud was discovered by the Securities & Exchange Commission on July 24, 1963. Consequently the prospective purchasers of Paul H. Aschkar & Co. refused to take delivery of or pay for the Jerome, Richard & Co. stock and Paul H. Aschkar lost the $24,875 paid by it for the securities. Jerome, Richard & Co.'s stock is and always was worthless. [R. T. 52.] (For a full description of the fraud and its magnitude, see Affidavit of Frances J. Donnelly, investigator for the S.E.C. [Pl. Ex. 52, not admitted into evidence].)

During the period January 7, 1963 to July 19, 1963, the commissions generated by Ross and Grossinger for Kamen & Co. exceeded $182,000. [Pl. Ex. 59.] Although both Ross and Grossinger were registered representatives working on a 40% commission basis, Kamen & Co. paid Grossinger a flat sum of $530.00 per month and paid all of the remaining 40% to Ross. [Pl. Ex. 55 and 56.]

The total amount of the commissions generated by all of the partners and employees of Kamen & Co. (other than Ross and Grossinger), for the period January 1 to July 31, 1963 was $139,000.00. [R. T. 234-235.] During the above period Kamen & Co. had two general

partners and ten employees of which eight were employed throughout the 7-month period. [R. T. 233, 229-232.] During this period, the next highest employee generated commissions of only $14,643.77. [R. T. 233.] The employees as a group generated commissions of only $82,000.00 during this full 7-month period and the two general partners together generated commissions of approximately $50,000.00. Although Ross and Grossinger had only eighteen months and thirty-six months experience in the securities business respectively [R. T. 234, 237], they procured over $40,000.00 more in commissions for Kamen & Co. than the two general partners and ten employees combined and over twelve times the commissions procured by the next highest employee. Moreover, Kamen must have thought that Ross, with only one and one-half years' experience, was generating all of this business since he paid him on the basis of all of the commissions except for $530.00 paid bi-monthly to Grossinger.

For a period of nearly two months,[1] Ross solicited and generated this large volume of business in the same room with Mr. Kamen, Kamen's partner and eight other employees. Mr. Kamen was separated from Ross by only a banister. [R. T. 211, 219.] Thereafter, from March 1 to July 24, 1963, the solicitations took place in a separate office furnished by Kamen & Co. to its special over-the-counter division. This office adjoined Mr. Kamen's office, being separated therefrom by an ordinary office wall.

Nevertheless the Court found that the partners of Kamen & Co. did not know or have reason to know of the fraud being committed by the manager of their broker-dealer division.

[1]January 7, 1963 to the end of February, 1963.

The court, however, further found that the fraudulent scheme was perpetrated by the managerial and other employees of Kamen & Co. within the scope of their employment and that such fraud was engaged in by such employees for the purpose of inducing various broker-dealers to give their listed business to Kamen & Co., which was the object of their employment. [Find. 21.] Moreover, the court found that the fraudulent employees were hired by Kamen & Co. for the specific purpose of soliciting a large volume of listed business from over-the-counter dealers [Find. 12], that in order to obtain such business Kamen & Co. established a broker-dealer division and gave Ross and Grossinger actual authority to manage such division and implied actual authority to place over-the-counter orders with certain broker-dealers [Find. 13], that the fraudulent employees were actually authorized to use and did actually make substantial use of the offices and equipment of Kamen & Co. to carry out their fraudulent scheme [Find. 15], that the fraudulent employees had actual authority to solicit business from appellee and other broker-dealers, that the fraudulent employees had ostensible authority to make the false representations and engage in the fraudulent conduct heretofore described [Find. 22] and that the fraudulent employees were vested by Kamen & Co. with ostensible authority to offer and place the fraudulent Jerome, Richard & Co. Inc. transactions. [Find. 23.] Although the trial court was of the opinion that the practice of giving reciprocal business of the nature given in this case violated the New York Stock Exchange Rules so far as Kamen & Co. was concerned, it found that these practices were not illegal insofar as the Paul H. Aschkar & Co. participation therein was concerned and, though unusual,

not so unusual as to put Paul H. Aschkar & Co. upon notice or require it to investigate or doubt the extent of the authority extended to Ross and Grossinger. [Find. 35.]

The court further found that Ross and Grossinger impliedly represented that the over-the-counter transactions placed by them were bona fide business transactions [Find. 19] and that Paul H. Aschkar & Co. was not negligent in relying upon the representations made by Ross and Grossinger but to the contrary was justified in relying thereon. [Finds. 29, 36.]

B. Appellants' Contentions.

Appellants contend that:

1. the Court of Appeals should ignore the findings of the trial court and retry *de novo* the factual questions which determine Kamen & Co. liability for the acts of its employees;

2. the trial court was clearly erroneous in finding that the fraud heretofore described was committed by appellants' manager and other employees within the scope of their employment and within the ostensible authority and agency power vested by appellants in such manager and other employees;

3. whenever a fraud involves the successive victimization of a number of persons arranged in a chain transaction, a person who has suffered an actual cash loss of $24,875 must proceed against the prospective victim following him in the chain before proceeding against the persons perpetrating the fraud.

These contentions are discussed in Arguments I-III, *infra*. None of them are sustained by the facts of this case or the law pertaining thereto.

ERRORS RELIED UPON BY CROSS-APPELLANT.

The judgment of the trial court is fully supported by its Findings of Facts and Conclusions of Law. Appellee, however, believes that the same judgment is required on legal and factual bases either ignored by the trial court or rejected by that court. Consequently, appellee has filed a cross-appeal. Cross-appellant's errors relied upon are:

1. The trial court erred in failing to conclude that the duties imposed by the Securities Act of 1933 and the Securities Exchange Act of 1934 on members of national exchanges are non-delegable and that any violation thereof by an employee renders his employer civilly liable to the same extent as if the employer himself violated the Acts.

2. The standard of care imposed by the trial court on a member firm of the New York Stock Exchange in supervising the activities of its employees was shockingly inadequate.

3. The court erred in refusing to admit into evidence a report in affidavit form prepared by an investigator for the Securities and Exchange Commission in the performance of his official duties proving that Appellants had knowledge of the fraud being committed by their employees.

OUTLINE OF ARGUMENT.

I.

This Appellate Court Should Not Retry *De Novo* the Questions of Apparent Authority and Whether the Fraud Was Committed in the Scope of the Employment of the Manager of Kamen & Co.'s Broker-Dealer Division. Such Questions Are Questions of Fact and the Trial Court's Findings Thereon Should Not Be Set Aside Unless Clearly Erroneous.

II.

The Evidence Fully Supports the Trial Court's Findings That the Manager of Kamen & Co.'s Broker-Dealer Division Perpetrated the Fraud While Acting Within the Scope of His Employment, That Such Manager Was Ostensibly Authorized to Place the Fraudulent Jerome, Richard Transactions and That Appellee Was Not Negligent in Relying Upon Such Manager's Misrepresentations.

1. Appellants Are Liable for the Acts of the Manager of Their Broker-Dealer Division Because Appellants Vested Such Manager With the Apparent Authority to Place the Fraudulent Reciprocal Transactions.

2. Appellants Are Liable for the Acts of the Manager of Their Broker-Dealer Division Because Such Manager Committed the Fraud While Acting Within the Scope of His Employment.

III.

A Victim of a Fraud Which Involves the Successful Victimization of a Number of Persons Arranged in a Chain Transaction Is Not Required to Proceed Against the Prospective Victim Following Him in the Chain Before Proceeding Against the Persons Perpetrating Such Fraud.

IV.

A Member of the Securities Industry Has a Non-Delegable Duty to All With Whom He Deals to Deal Honestly and Fairly.

V.

The Standard of Care Imposed by the Trial Court on New York Stock Exchange Member Firms for the Supervision of Their Employees Failed to Conform to Current Standards and Is Reminiscent of a Rejected Era in the Securities Industry.

VI.

The Trial Court Erred in Refusing to Admit the Certified Affidavit of Francis J. Donnelly.

ARGUMENT.

I.

This Appellate Court Should Not Retry De Novo the Questions of Ostensible Authority and Whether the Fraud Was Committed in the Scope of the Employment of Kamen & Co.'s Broker-Dealer Division. Such Questions Are Questions of Fact and the Trial Court's Findings Thereon Should Not Be Set Aside Unless Clearly Erroneous.

The trial court heard testimony for three days concerning the purpose for which Ross and Grossinger were employed, the duties they performed, the responsibilities placed upon them, the authority actually and impliedly granted to them, the title given to Ross, the direct and indirect communication by Kamen & Co. of Ross's responsibilities and powers, the conduct of Ross and Grossinger while employed by Kamen & Co. and all of the facts bearing on the relationship among Kamen & Co., Ross, Grossinger and appellee. After hearing such testimony the trial court found that Ross and Grossinger perpetrated the fraudulent Jerome, Richard & Co., Inc. transactions while acting within the scope of their employment [Find. 21] and further found that these employees possessed the ostensible authority to place the fraudulent Jerome, Richard transactions. [Finds. 22, 23.]

Federal Rule of Civil Procedure 52a provides that such findings shall not be set aside unless "clearly erroneous."

Appellants, however, contend that Rule 52a does not apply "where there is no substantial dispute as to the evidentiary facts from which ostensible authority is to be determined. . . ." (App. Br. p. 14.)

This contention has been expressly rejected by the Supreme Court in *C.I.R. v. Duberstein,* 363 U.S. 278, 289, 291, 80A S. Ct. 1190, 1198-1200, 4 L. Ed. 2d 1218, 1227-1228 (1960), by the Ninth Circuit Court of Appeals in *Lundgren v. Freeman,* 307 F. 2d 104, 113-115 (9th Cir. 1962), and by the Advisory Committee note to Federal Rule 52a.[2]

Thus, in *C.I.R. v. Duberstein, supra,* the Supreme Court reviewed two cases in which the triers of fact were required to determine whether a transfer of property was a gift exempt from income tax or compensation subject to tax. In each case the facts were undisputed. Nevertheless the court held that the trier of facts resolution of this question could not be set aside unless clearly erroneous. The court stated that Rule 52a applies "also to factual inferences from undisputed facts." (*Id.,* at 291.) Moreover, the court expressly criticized the technique of formulating a question as a "mixed question of fact and law" in order to permit a broader scope of view. (*Id.,* at 289, footnote 11.)

In *Lundgren v. Freeman, supra,* the trial court found that, due to a mutual mistake, a written contract did not properly reflect the intent of the parties. In that case as in this one, appellant argued that the findings

[2]The Advisory Committee's Note states:

> "It (the clearly erroneous rule) is applicable to all classes of findings in cases tried without a jury whether the finding is of a fact concerning which there was a conflict of testimony, of a fact deduced or inferred from uncontradicted testimony." (Words in parentheses added.)

of the trial court should be ignored because they were based on undisputed facts. After a careful analysis of this question and an extended discussion of the predominant case law and comments of Judge Clark, Judge Frank and Professor Moore this court held:

> "We are bound by Rule 52a F.R. Civ. P., which provides that: 'findings of fact shall not be set aside unless clearly erroneous. * * *' Therefore, we may not substitute our judgment if conflicting inferences may be drawn from the established facts by reasonable men, and the inferences drawn by the trial court are those which could have been drawn by reasonable men." (*Lundgren v. Freeman,* 307 F. 2d at 113.)[3]

The holding of *Lundgren* has been reaffirmed by this court every year since 1962. (*Teren v. Howard,* 332 F. 2d 949, 952 (9th Cir. 1963), [Extent of domination of President of corporation over board of directors]; *United States v. First Security Bank,* 334 F. 2d 120, 121 (9th Cir. 1964), (whether income was properly part of an insurance business or banking business); *Stauffer Laboratories Inc. v. F.T.C.,* 343 F. 2d 75, 78 (9th Cir. 1965), [whether text of ads are misleading].)

The test of whether an inference drawn from undisputed facts is a conclusion of law or a factual determination depends upon whether such inference is derived from having had "experience with the mainsprings of human conduct." (*C.I.R. v. Duberstein,*

[3]See also *Widney v. U.S.,* 178 F. 2d 880 (10th Cir. 1949) "If, from the established facts, reasonable men might draw different inferences, it is not within the province of this court to substitute its judgment for that of the trial court as to which inferences should be drawn."

supra, 363 U.S. at 289; *Lundgren v. Freeman, supra,* 307 F. 2d at 115.)[4]

Clearly, the inferences which must be drawn from evidentiary facts to determine whether the acts of a principal vested his agent with ostensible authority, the extent of the ostensible authority, the reasonableness of a third

[4]The cases cited by appellants are distinguishable on this basis. Thus, in the case of *Kippen v. American Automatic Typewriter Company,* 324 F. 2d 742 (9th Cir. 1963), cited by appellants, the Court held that the law imposed a legal duty on defendant to warn plaintiff to stop drinking before defendant's franchise could be terminated for good cause. The trial court, however, through its finding indicated that no such warning was required. In *Brown v. Cowden Livestock Co.,* 187 F. 2d 1015 (9th Cir. 1951) this court held that as soon as plaintiff discovered that defendant had paid the purchase price for plaintiff's cattle to plaintiff's agent, plaintiff was under a legal duty to advise defendant that such agent was not authorized to receive payment. This court further held that, as a matter of law, plaintiff could not permit its agent to retain part of the purchase price as a loan from plaintiff and at the same time take the position that it had not received the payment from defendant.

In *Stevenot v. Norberg,* 210 F. 2d 615 (9th Cir. 1954), the trial court was of the opinion that certain employees had vested rights to continued employment. On the basis of this erroneous legal view the court found that it would be in the best interest of the bankruptcy estate not to fire such employees. The appellate court held that this "finding" was not binding on it because the Finding was based upon the erroneous legal conclusion that such employees had a right to continued employment and that in any event the discretion to fire or hire employees was vested by a former order of the trial court in the trustee for the estate and thus should not be interfered with by the trial court.

In *Plomb Tool Co. v. Sanger,* 193 F. 2d 260, 264 (9th Cir. 1952) the appellant challenged the trial court's conclusions of law, not its findings of fact.

The two trademark cases cited by appellant are likewise inapposite. In *Fleischmann Distilling Corp. v. Maier Brewing Company,* 314 F.2d 149 (9th Cir. 1963) the trial court was under a legal misapprehension that a similarity of product was required before the Lanham Act is applicable. Moreover, the courts have historically applied a different standard of review in patent and trademark cases. (See Yankowitch, *Findings in the Light of the Recent Amendments to the Federal Rules of Civil Procedure,* 8 F.R.D. 271, 291 (1948).)

party's reliance on such ostensible authority, the purpose for which an employee is hired and whether specific acts are within the scope of such employment are derived from the "mainspring of human conduct." To resolve such issues the trier of fact must determine the meaning which a reasonable person would attribute to the conduct of all the persons involved in the many varying factual circumstances of each case. This is exactly the kind of fact finding that the decisions of *C.I.R. v. Duberstein* and *Lundgren v. Freeman* have reserved to the trier of fact.

Thus, the question of ostensible authority has been held to be a question of fact not only in the Fifth Circuit case cited on pages 14 and 15 of appellants' brief (*Bogue Electric Mfg. Co. v. Coconut Grove Bank,* 269 F. 2d 1, 4 (5th Cir. 1959), but also in an additional Fifth Circuit case (*Gilmore v. Royal Indemnity Co.,* 240 F. 2d 101, 105-106 (5th Cir. 1956) and in cases from the Second Circuit (*Farmer v. Arabian American Oil Co.,* 277 F. 2d 46, 52 (2nd Cir. 1960)), the Third Circuit (*Lind v. Schenley Industries, Inc.,* 278 F. 2d 79, 84 (3rd Cir. 1960)), the Eighth Circuit (*Frank Sullivan Company v. Midwest Sheet Metal Works,* 335 F. 2d 33, 40 (8th Cir. 1964)) and the Tenth Circuit (*J. T. Majors & Sons, Inc. v. Lippert Bros. Inc.,* 263 F. 2d 650, 654 (10th Cir. 1958), *American Nat. Bank of Sapulpa, Okl. v. Bartlett,* 40 F. 2d 21, 22 (10th Cir. 1930)).[5]

[5]The law of California, similarly, provides that the question of ostensible authority and the extent of an agents ostensible authoirty is a question of fact unless the evidence is so conclusive that reasonable men can draw only one conclusion therefrom. (*State F. Co. v. Hershel Calif. F.P. Co.,* 8 Cal. App. 2d 524, 527 (1935). In *State F. Co. v. Hershel Calif. F.P. Co.,* 8 Cal. App. 2d at 528, the court stated "the existence of an agency, like the extent of an agent's authority, is a question of fact." (Accord: *California Viking Sprinkler Co. v. Pacific Indem. Co.,*

Likewise in *Garebedian v. Griffin Steel & Supply Co.* 340 F. 2d 478, 479-480 (9th Cir. 1965) this Court applied the clearly erroneous rule to a finding by a referee in bankruptcy that the person served with process was not an agent possessing sufficient actual or apparent authority to validate such service.

Not only is appellants' legal argument that the question of ostensible authority is a question of law untenable but their assertion that the facts involved in this case are undisputed is unfounded. The facts relating to the question of appellee's justifiable reliance on the representations made by Ross and Grossinger were very much in dispute. (Compare the testimony of appellants' expert witness [R. T. 391] and Paul H. Aschkar [R. T. 81-90] and John B. Bailey [R. T. 163-165].) Although the evidentiary facts relating to Ross's actual authority, apparent authority and scope of employment were not basically in dispute, such facts permitted the court to draw widely varying inferences as to the extent of Ross's apparent authority and scope of employment. The trial court's finding that the fraud was perpetrated by Ross and Grossinger while they were acting within the scope of their employment and that they were ostensibly authorized to place the fraudulent transactions should therefore not be disturbed unless they are clearly erroneous.

213 Cal. App. 2d 844, 850 (1963); *Torrance N. Bk. v. Enesco F. Credit Union*, 134 Cal. App. 2d 316, 325 (1955); *Maron v. Swig*, 115 Cal. App. 2d 87, 90 (1952) [a fraud case]; *House Grain Co. v. Finerman & Sons*, 116 Cal. App. 2d 485, 492 (1953) ["The issue of ostensible agency is one of fact"]; *Thompson v. Machado*, 78 Cal. App. 2d 870, 877 (1947); *Ghiglione v. American Trust Co.*, 49 Cal. App. 2d 633, 638 (1942) [fraud by employee]; *United Air Services, Ltd. v. Sampson*, 30 Cal. App. 2d 135, 140-141 (1938); *Bridge v. New Amsterdam Casualty Co.*, 129 Cal. App. 365, 367-368 (1933).) The one case cited by appellants, *Fairbanks v. Crumb Inc. etc. Co., Inc.*, 108 Cal. App. 197, 210 (1930) is the only case containing a statement to the contrary and as to such statement must be deemed to be overruled.

II.

The Evidence Fully Supports the Trial Court's Findings That the Manager of Kamen & Co.'s Broker-Dealer Division Perpetrated the Fraud While Acting Within the Scope of His Employment, That Such Manager Was Ostensibly Authorized to Place the Fraudulent Jerome, Richard Transactions and That Appellee Was Not Negligent in Relying Upon Such Manager's Misrepresentations.

The court found that appellants are liable for the acts of the manager of their broker-dealer division because:

(1) Appellants vested such manager with the ostensible authority to place the fraudulent reciprocal transactions, and

(2) Such manager committed the fraud while acting within the scope of his employment.

Since these findings provide two distinct and separate bases for appellants' liability for the acts of their employees, appellee will discuss them under separate subheadings.

1. Appellants Are Liable for the Acts of the Manager of Their Broker-Dealer Division Because Appellants Vested Such Manager With the Ostensible Authority to Place the Fraudulent Reciprocal Transactions.

A principal is liable for the tortious acts and statements of his agent if the agent purported to speak for his principal and there was reliance upon ostensible authority or if the agent was aided in the commission of the tort by the agency relationship. (*Gleason v. Seabord Ry.*, 278 U.S. 349, 353-354; 49 S. Ct. 161, 161-162; 73 L. Ed. 415, 417-418 (1929); *Rutherford v.*

Rideout Bank, 11 Cal. 2d 479, 484 (1938); Rest. of Agency §§219 (2) (d), 257, 266.)

Appellants admit that in the early part of January, 1963, they hired Ross for the purpose of soliciting listed business from broker-dealers all over the United States. [R. T. 226, 245-246.] A special division was formed within Kamen & Co. for this purpose and Ross was put in full charge thereof. Ross was furnished with a separate office and with three employees, a registered representative, a secretary and a clerk. [R. T. 208.] Specialized telephonic equipment was put at Ross's disposal and he was authorized to offer to broker-dealers a variety of special services and research material in return for their listed business.

It is clear that, without the facilities of Kamen & Co. and the position occupied by Ross as the manager of its broker-dealer division, the fraud would have been impossible. Thus, the agent was aided in the commission of the tort by the agency, relationship. This basis of liability is often referred to as agency power.

In the instant case, however, there was not only agency power but also ostensible authority. Ross, as manager of the broker-dealer division was not just an employee but an executive with wide authority over the operations of his division.

Appellants expressly and impliedly communicated Ross's broad authority to each of the broker-dealers throughout the United States with whom Kamen & Co. desired to establish a business relationship. Thus, appellants printed a business card for Ross describing him as the manager of the broker-dealer division of Kamen & Co., and authorized Ross to send such cards

to appellee and others. Appellants authorized Ross to call various broker-dealers throughout the United States, to introduce himself as the manager of appellants' broker-dealer division, and to solicit the broker-dealer listed business for Kamen & Co. Appellants confirmed and executed the listed business procured by Ross. Appellants made the specialized research facilities of its clearing agent, Carl. M. Loeb, Rhoades & Co., available to the broker-dealers contacted by Ross [R. T. 274-276] and gave such broker-dealers expensive phone privileges and special price quotation services. [R. T. 273-274.]

The foregoing conduct of appellants, coupled with the custom of reciprocal business in the securities industry, quite naturally indicated to the broker-dealers solicited by Kamen & Co. that Ross was the person responsible for distributing Kamen & Co.'s reciprocal business, thus vesting Ross with the ostensible authority to do so.[6] Appellants do not seriously dispute Ross's ostensible authority to give up legitimate over-the-counter transactions. Appellants argue, however, that the Jerome, Richard trades fell outside the regular and ordinary course of business and thus appellee was unreasonable in relying on the ostensible authority vested by them in Ross. This contention is of course directly contrary to the court's finding that appellee was "not negligent in relying on the representations of Ross and Grossinger and was justified in relying thereon." [Find. 29.]

[6]This is the complete answer to appellants suggestion that appellee should have checked with a principal of Kamen & Co. (App. Br. p. 30). Appellee was already in touch with Ross, the manager of their broker-dealer division who was vested by appellants with so much authority, that he was the only one with whom a reasonable person would check.

In order to buttress their contention that appellee was not justified in relying on Ross's misrepresentations, appellants conjured up six items connected with the transactions which they deem to be unusual. (Footnote on page 21 of Appellants' Brief.)

Appellants state that the transactions were unusual because the profit appellee was to receive on the Jerome, Richard transactions exceeded the commission business that appellee had given to Kamen & Co. This was certainly true on July 10, 1963 since on that day Kamen & Co. gave up a transaction on which Paul H. Aschkar & Co. was to earn $87.50 and Paul H. Aschkar & Co. had not yet given any business to Kamen & Co. This trend, however, was quickly reversed and by July 16th (one day prior to the next order given up by Kamen & Co.) appellee had placed orders with Kamen & Co. on which they realized commissions of $118.25. [R. T. 128.] On the next day, Kamen & Co. gave two more orders to appellee which, when executed, would have given appellee a gross profit of $324.50. Thereafter, appellee gave Kamen & Co. additional listed business, the exact amount of which does not appear in the record. Kamen earned $48.75 on such business and had other listed orders on hand when the fraud was discovered.

Reciprocal business arrangements between a New York Stock Exchange Member and a non-member usually require the non-member firm to give up to the member firm between $1.50 to $3.00 of commissions for each $1.00 of business given by the member firm to the non-member. (Appx. A, p. 302.) Although in the aggregate the ratio always favors the member firm, it is clear that at any one particular moment, over a short period of time (*i.e.* in the instant case less than three weeks),

the member firm may be behind. Legitimate business can only be given up when an order is placed by a customer. Sometimes the non-member firm gets a large number of listed orders and sometimes the member firm gets a large number of over-the-counter orders. The member firm can only give up the over-the-counter orders when and as it receives them. Over a substantial period of time, however, the member firm will receive more than it gives up, otherwise it will withdraw from the arrangement. The fact that during part of a three-week period Kamen & Co. gave up more than it received is certainly not an unusual circumstance.

In order to buttress their contention that such circumstance is unusual, appellants deduct from the commissions actually received by Kamen & Co. the salary of its employees and the amount paid by it to its clearing agent. It is clear, however, that both non-member firms and member firms must pay salaries and other expenses from their gross earnings. Appellee cleared its own transactions. Presumably appellant paid for a clearing agent because it found that arrangement more economical than hiring employees for that purpose.

The second unusual circumstance conjured up by appellants is that, after the transactions had been entered into, appellee received an instruction to either take delivery from a broker who was not a seller or to deliver to a broker who was not the buyer.

The clearing and shipment of stock takes time. Thus, on July 23rd appellee first received the 600 shares purchased on July 10th and still had not obtained delivery of 1,000 shares purchased on August 17th. Often a sale can be made in the intervening time. This is all that

such "change order" indicates. It is true that Paul H. Aschkar could deduce from such change order (if he dissected the transactions) that four brokers had purchased the shares either for themselves or for customers at slightly higher prices. The period of time over which such rise took place could not be ascertained from the documents in appellants' possession but as indicated in this case such period could easily encompass thirteen days. Certainly a rise of ½ to 1 point over a period of two weeks on a stock selling at $19 is not unusual; nor is the fact that the stock has risen in 1/8 or ¼ increments unusual. Appellants brought a professional expert witness all the way from New York. Yet such witness did not testify that the change orders or price increases were unusual circumstances.

Thirdly, appellants contend that the disclosure of the lower seller by Cirlin & Associates was unusual. The only reason for Cirlin to not disclose the lower seller is to prevent appellee from going directly to such source of supply. Appellee, however, was not making a market in Jerome, Richard stock. Cirlin had little to fear from him. Can it truthfully be said that the court was clearly erroneous in finding that appellee was not negligent because, after receiving such change order, appellee did not immediately say to himself, "Why isn't Cirlin afraid that if some time in the future I have a need for Jerome Richard stock I will first check with the other broker, whose name he revealed to me in his change order?"

Fourth, appellants contend that the transactions were unusual because over a period of eight minutes the price of the stock fluctuated by 1/8th of a point and thus eight minutes later Cirlin had to purchase the stock

for 1/8th more than it has previously sold similar shares. The only testimony in the record states that this is not at all unusual. [R. T. 294.] A specialist either on an exchange or over the counter continuously purchases and sells stock at slightly varying prices minutes apart. [R. T. 182-183.] Appellants further contend that it must have seemed strange that appellee could always find a buyer at a higher price than Cirlin who, since he had three transactions in the Jerome Richard stock, must have seemed to be relatively active in the stock. Three transactions are hardly an indication that someone is very active in a stock. Moreover, it was Kamen & Co. and not appellee who found the buyer at a higher price and Kamen & Co. appeared at least as active in the stock as Cirlin.

The fifth unusual circumstance pointed to by appellants is that the stock did not appear in the "pink sheets" within three months of the transactions in question. This statement is incorrect. There was a listing "OW" "BW" (offer wanted, bid wanted) within a few days of the transaction. [R. T. 86.] Moreover, there was a price of $17 quoted in May approximately six weeks previously. The fact is that it is very common for the pink sheets to list stock "OW" "BW." This merely means that the broker who is called by the quotation service is not willing to give a price in the absence of a concrete transaction involving a definite number of shares. Again there is absolutely no testimony, not even by appellants' expert witness that such listings or the absence of a definite price for the time period here involved is unusual.

The sixth unusual aspect asserted by appellants is that there was no confirmation or acknowledgement be-

tween appellants and Kamen & Co. concerning the Jerome, Richard transactions. Appellee sent confirmation slips to the buyer and seller of the stock. Kamen sent confirmation slips in regard to the listed business given to it by appellee. These are the only written confirmations which are customary in the industry. The "give-up" itself was accomplished by telephone. Most of the business in the securities field is accomplished over the telephone. It is not unusual that the Jerome Richard trades were not further acknowledged by appellee and Kamen. The fact that this is not unusual is borne out by the apparent absence of such communication to Kamen & Co. from any of the other hundreds of broker dealers called by Ross and Grossinger. Here also there is no testimony whatsoever supporting appellants' assertion that the absence of such written communications is unusual.[7]

Consequently, although appellants have laboriously analyzed and dissected the Jerome, Richard transactions, the record fails to disclose any unusual circumstance connected with the transaction other than appellants' professional witnesses [R. T. 373] testimony that the "give up" of both a buyer and a seller is very unusual. Appellants further contend and the trial court held that such a "give up" violates the New York Stock Exchange Anti-rebate Rule.

Appendix A hereto contains part of the study of the Securities and Exchange Commission into "give-ups" and other forms of rebate by New York Stock Exchange members to non-members.

[7]Likewise there is absolutely nothing in the record to support appellants', insinuation that Paul H. Aschkar intentionally or otherwise "kept the transaction to himself." (App. Br. p. 30.)

This study shows that a large number of so-called "fixed profit" reciprocal business arrangements are accepted by the New York Stock Exchange as not violating its Anti-rebate Rule.

Thus, on page 302, the S.E.C. Study states:

> "The member desiring to reciprocate for commission business given him by a nonmember professional can do so by returning commission business to the nonmember. There are several methods, only the most important of which can be mentioned here: he may place business on a regional exchange with a nonmember who is a member of that exchange even though (a) the member is also a member of the regional exchange (dual member) and could have placed the business there directly or (b) the security is traded on the NYSE as well as the regional exchange (dual listing) so that the dual member could have effected the transaction directly on the NYSE."

The foregoing is a fixed profit transaction, the member firm supplies the buyer or seller for the security and the regional exchange supplies the other party to the trade. The regional exchange member merely performs the clearing duties also performed by appellee in this case.

The S.E.C. Study goes on to state:

> "He may place orders for unlisted securities with the nonmember to be transacted over the counter, even though the member firm may have a trading department capable of effecting the transaction directly."

This, of course, is what appeared to appellee to be taking place in the instant case. Kamen & Co. appeared to have completed an over-the-counter trade which they turned over to appellee in return for the business they hoped to receive from appellee.[8] The S.E.C. Study states:

> "Return by an NYSE member of cash to his reciprocal correspondent for commission business would violate the antirebate rule cited above, but the return of a cash equivalent in the form of profitable security commission business which might have been transacted directly by the NYSE member is permissible. The distinction is obviously a fine one and it has produced a fertile field for administrative interpretation."

Of course a transaction arranged solely for the purpose of giving a profit to an over-the-counter broker-

[8]There are numerous other reciprocal business arrangements through which over-the-counter broker-dealers are given fixed profit transactions either by member firms in return for listed business or by mutual funds in return for selling mutual fund shares. In many of these arrangements the over-the-counter broker-dealer is provided with both a buyer and seller. (See Appendix A, part 4, pp. 224-228.) These arrangements have the express or tacit approval of the various exchanges including the New York Stock Exchange. Apparently these arrangements are not questionable if (as in the instant case) the broker-dealer performs the expensive and time-consuming execution and clearance services. Kamen & Co. pays as much as 40% of its commissions to Carl M. Loeb, Rhoades & Co. for these clearance services.

Many exchanges other than the New York Stock Exchange and American Stock Exchange expressly permit rebates to broker-dealers who, like appellee, are members of the National Association of Securities Dealers. (Report of Special Study of Securities Markets of the Securities and Exchange Commission Part 2, pp. 299-300.)

It is to be noted that in this case (as opposed to some mutual fund situations) there existed no conflict of interest. The listed securities were purchased for the minimum commission set by the exchange and could not be purchased for less.

dealer violates the rebate rule. Appellee, however, did not know that the Jerome, Richard transactions were not legitimate trades received by Kamen & Co. but were in fact "arranged transactions" fraudulently induced by the manager of appellants' over-the-counter division. [Finds. 25, 27, 32, 18.]

It is because of the foregoing custom of reciprocal business that Mr. Bailey testified that a reasonable broker's suspicion would not be aroused by the Jerome Richard transactions [R. T. 163-165] and that Paul H. Aschkar testified that he was not suspicious of the transaction. [R. T. 81, 90.][9]

In light of the New York Stock Exchange's express approval of the reciprocal business transactions set forth in the record and the S.E.C.'s report, the accuracy of the court's conclusion that the "give-ups" involved in this case violated the rules of the New York Stock Exchange is open to serious doubt.[10] In any event, re-

[9]The fact that appellee did not have a previous similar transaction is totally irrelevant. He was aware of the custom of reciprocal business in the industry [R. T. 15], even though he had not been "favored" with this particular type of reciprocity before.

Appellants' expert witness's testimony that the transaction would make "his hair stand on end" is not persuasive. Mr. Cohon has a very strange view of the usual. To him the Jerome, Richard transactions were very unusual but Ross's earnings in the amount of $182,000 over a few months period was not at all unusual. In his view these huge earnings were merely reward for "hard work". [R. T. 378-379, 399 but compare 397.] The trial court had the opportunity to observe appellants' expert witness and obviously did not set great store in his testimony.

[10]Appellants often refer to the "illegality" of the purported rebate. With all due respect to the New York Stock Exchange, its rules are not law. To the contrary it is very likely that the antirebate rule of the Exchange is a *per se* violation of the Sherman Anti-Trust Act and is therefore totally invalid. (*Silver v. New York Stock Exchange,* 373 U.S. 341, 357, 83 S.Ct. 1246, 1257, 10 L. Ed. 2d 389, 400 (1963); *United States v. Socony-Vacuum Oil Co.,* 310 U.S. 150, 210, 60 S.Ct. 811,

gardless of whether such transactions fell on one side or the other of the fine line drawn by the exchange, the trial court's finding that the transactions, although "unusual, were not so unusual *or* shocking[11] as to put the plaintiff upon notice or require it to investigate or doubt the extent of the authority extended to Ross and Grossinger" [Find. 35] and its further finding that appellee "was not negligent in relying on the representations made by Ross and Grossinger but was justified in relying thereon" [Finds. 29, 36] are certainly not clearly erroneous.

2. Appellants Are Liable for the Acts of the Manager of Their Broker-Dealer Division Because Such Manager Committed the Fraud While Acting Within the Scope of His Employment.

Even if the reciprocal transactions offered by Ross were unusual, appellants would nevertheless be liable for the tortious acts of their employees committed within the scope of their employment.

The basic Restatement of Agency section dealing with an employer's liability for the *torts* of his employees is § 219. This section provides:

> "§219. When Master Is Liable for Torts of His Servants.[12]

838; 84 L. Ed. 1129, 1161 (1940); See, Jennings, *The New York Stock Exchange and the Commission Rate Struggle,* 53 Calif. Law Rev. 1119, 1131-1140.)

[11](Emphasis added.) The court used the disjunctive between the words "so unusual" or "shocking", thus finding that the transaction was neither so unusual nor so shocking as to put plaintiff on notice. It is clear, therefore, that contrary to appellants' contention (App. Br., p. 23) the court was not of the opinion that the transaction had to be shocking before plaintiff's reliance would be unjustifiable.

[12]Under the restatement definition Ross and Grossinger were servants of Kamen & Co. (See Rest. of Agency 2d § 220.)

(1) A master is subject to liability for the torts of his servants committed while acting in the scope of their employment.

(2) A master is not subject to liability for the torts of his servants acting outside the scope of their employment, unless:

(a) the master intended the conduct or the consequences, or

(b) the master was negligent or reckless, or

(c) the conduct violated a non-delegable duty of the master, or

(d) the servant purported to act or to speak on behalf of the principal and there was reliance upon apparent authority, or he was aided in accomplishing the tort by the existence of the agency relation."

Section 219 contains two numbered subsections. Under subsection (1) the only question is; did the employee act within the scope of his employment? If so, the other questions raised by subsection (2); the master's intent, the master's negligence, the violation of a non-delegable duty and the existence of apparent authority (and reasonable reliance on apparent authority) never arise.[13]

[13]Appellants' reliance on §§166, 258, 261 and 262 of the Restatement of Agency is misplaced.

§166 applies only to the power of an agent to bind his principal to a contract. Thus Chapter 6 including §§140-211 is entitled "Liability of Principal to Third Persons, Contracts and Conveyances", while Chapter 7 including §§212-267 is entitled "Liability of Principal to Third Persons, Torts". (See 1 Rest. of Agency, pp. 346, 451.) The power of a servant to render his principal liable for a tort is far greater than his power to bind him to a contract. That is why the two subjects are treated separately in the Restatement.

Restatement of Agency §§261 and 262 cited by appellants are likewise inapposite. A fraud may be committed by an employee

In a tort case, the normal or unusual appearance of the tort is totally irrelevant. In most cases this is too clear for argument. Driving at excessive speeds or assuming a belligerent attitude towards a customer and

solely to benefit himself or to benefit both himself and his employer. The latter are usually commission cases. An employee of course rarely commits a fraud solely to benefit his employer. When a fraud is committed solely to benefit the employee, it is not committed in the scope of the servant's employment. In such cases liability of the employer rests solely on apparent authority or agency power. Sections 261 and 262 of the Restatement are intended to apply to these torts. Thus the Reporter's Notes to §261 provide:

> "§261 Agent's position Enables Him to Deceive." This note deals primarily with the situations in which the agent acts on his own account and not in the interests of the principal and hence includes cases involving not only the rule stated in this section but also the rule stated in §262. . . . (Restatement of Agency 2d Appendix, p. 420.)

In the instant case, although Ross received a portion of the commissions, the fraud was perpetrated to increase the business of Kamen & Co.

Moreover, even under the rules stated in §§261 and 262 appellants are liable. The whole of §262 Comment "c" (only a portion of which is quoted by appellants) provides:

> "Third Person vs. Principal
>
> c. *Contributory negligence on the part of the deceived person is not generally recognized as a defense,* However, if a third person should know or otherwise has notice that an agent is acting for his own purposes or is otherwise violating his authority, the principal is not liable. See §§165 and 166." (Emphasis added.)

Comment *c* includes the words "otherwise violating his authority", however, since Sections 261 and 262 were intended to apply solely to frauds committed by an employee for his own account and thus committed outside the scope of his employment, the comments thereto must be read in this context. The proper interpretation of Comment *c* to Section 262 is that appellants are not liable if appellee knew or should have known that Ross was intending only to benefit himself, or was otherwise acting outside the scope of his employment.

This appellee could not know since Ross clearly was benefiting his employer and Ross was doing exactly what he was hired to do, soliciting listed business from over-the-counter broker-dealers. As is explained in the text *infra* the fact that Ross used prohibited

then punching him in the nose always differs from the customary transaction. Moreover, such acts are never actually or even apparently authorized. The principal is liable, however, because they are performed within the scope of the servant's employment.

California, federal case law, a large number of other jurisdictions and Mechem, a leading authority on the law of Agency, apply the rule enunciated in Restatement §219 to fraud and deceit cases without qualification.[14] (*Gleason v. Seaboard Ry.,* 278 U.S. 349 353-354, 49 S. Ct. 161, 161-162, 73 L. Ed. 415, 417-418 (1929); *National City Bank v. Carter,* 14 F. 2d 940, 941-942 (6th Cir. 1926); *Ralston Purina Co. v. Novack,* 111 F. 2d 631, 636 (8th Cir. 1940); *Mitchell v. Union Pa-*

means to solicit such business did not remove such solicitations from the scope of his employment.

For the exact same reason Comment *c* to Restatement of Agency §258, quoted by appellants (App. Br., p. 18) is inapposite to this case. §258 expressly provides that a principal is liable where the misrepresentations are made in connection with the subject matter entrusted to the agent (*i.e.* within the scope of his employment). The portion of Comment "c" quoted by appellants by its very terms excludes only instances where an agent makes statements concerning matters about which "the agent is not authorized to make statements". Ross as manager of the broker-dealer division was of course both actually and ostensibly authorized to speak about the subject matter of reciprocal business. [Find. 13.] (See also Comment a, §257 "If the statement is one which, if true, the agent would be authorized or apparently authorized to make, the principal is subject to liability for it although deceitfully made . . .".)

[14]The Restatement has special sections dealing with the tort of misrepresentation. (§257-264.)

Section 251 provides that a principal is liable for a servant's misrepresentations if the representation is (a) authorized, (b) apparently authorized, or (c) within the power of the agent to make for the principal. As can be seen from Comment *a* to §257 (see bottom 4 lines of footnote 13 *supra*) the words "within the power of the agent to make for the principal" closely resembles the more general formulation of the rule that the principal is liable if the misrepresentation is made within the scope of employment.

cific Railroad Co., 188 F. Supp. 869, 873 (S. D. Calif. 1960); *J. C. Millett v. Park & Tilford Distillers Corp.,* 123 F. Supp. 484, 495-496 (N.D. Calif. 1954); *Rutherford v. Rideout Bank,* 11 Cal. 2d 479, 484 (1938); *Blackburn v. Witter,* 201 Cal. App. 2d 518, 520-522 (1962); *Walsh v. Hooker & Fay,* 212 Cal. App. 2d 450, 456-457 (1963); *Ghiglione v. American Trust Co.,* 49 Cal. App. 2d 633, 637-638 (1942); *Von Schrader v. Milton,* 96 Cal. App. 192, 201-202 (1929); *Martin v. Leatham,* 22 Cal. 2d 442, 444 (1937); *Moynes v. Applebaum,* 218 Mich. 198, 187 N.W. 241, 242 (1922); Mechem, Law of Agency, §1984, p. 148 (1914).

In most of the above cases the particular transaction leading to the fraud differed radically from the usual transaction engaged in by such employees. Nevertheless, the employer was held liable.

Thus, in *Walsh v. Hooker & Fay, supra,* 212 Cal. App. 2d 450, 456-457, the registered representative employed by Hooker & Fay fradulently misrepresented a stock to a customer. The registered representative did not purchase such stock through Hooker & Fay. Instead, he purchased the stock through a broker named General American & Canadian Securities, Inc. The confirmation slip was on the latter's stationery. This procedure differed radically from all of the other transactions between Hooker & Fay and plaintiff. Nevertheless, the employer was held liable.

In *Blackburn v. Witter, supra,* 201 Cal. App. 2d at 520, 520-522, the registered representative sold plaintiff stock in a non-existent company. The customer received a different type of "receipt" than normally given by Dean Witter & Co. Moreover, the stock never ap-

peared on the monthly summary sheets mailed by Dean Witter to the plaintiff. Nevertheless, the employer was held liable.

In *Ghiglione v. American Trust Co., supra,* 49 Cal. App. 2d 633, 637-638 a manager of a branch bank represented to a customer that there were some good loans available which the bank could not take because of their long term, that the notes were adequately secured and that the bank would sell the security if the security depreciated. He further stated that such loans would give the customer an opportunity to earn 6% rather than 2%. The "giving-up" of loans by a bank was not customary. Nevertheless, the bank was held liable.

In *J. C. Millet & Co. v. Park & Tilford Distillers Corp., supra,* 123 F. Supp. 484, 495-496, an employee of the defendant attempted to obtain plaintiff's consent to act as a local distributor for defendant. Plaintiff attempted to get a no-cancellation clause but was refused. A non-cancellation clause was not customary in the industry. Plaintiff accepted the distributorship on the basis of the employee's oral representation that defendant had never in its history cancelled a distributor. This representation was false. The employer was nevertheless held liable. The court stated:

> "Park & Tilford would be liable for Cooperman's fraud only if he was acting within the scope of his employment. In a very real sense Cooperman's authority did not extend to making the fraudulent statements but that is not required. The question is whether the statements were made *in relation to the subject matter or business dealing in which the agent had authority.* The principal is liable for placing his agent in a position which enables the

agent while apparently acting within the scope of his authority to commit a fraud. Here Cooperman's authority as Western Sales Manager, extended to negotiating with and obtaining distributors for the Company. Even though he had no final authority in their ultimate selection, obtaining the distributor's consent to take on Park & Tilford's products was clearly within his authority. Millett reasonably so understood it. The representations went to the heart of this function. Park & Tilford is liable." (Emphasis added, *Id.* at 495-496.)

In the instant case the fraudulent representations of Ross were of course made in relation to the subject matter or business dealings in which the agent had authority. Ross and Grossinger were hired primarily for the purpose of soliciting listed business on behalf of Kamen & Co. from broker-dealers throughout the United States. Obtaining the consent of such broker-dealers to give their listed business to Kamen & Co. was clearly within Ross's actual authority. Moreover, Ross had actual authority to give up legitimate over-the-counter trades [Find. 13] "If the statement is one which if true, the agent would be authorized or apparently authorized to make, the principal is subject to liability for it although deceitfully made. . . ." (Restatement of Agency 2d, §257, Comment *a.*

Even in the absence of such authority Ross' actions were within the scope of his employment. Appellants admit that, in order to procure broker-dealers' listed business, it authorized Ross and Grossinger to phone

broker-dealers and offer them what Mr. Kamen thought were valuable research services and telephonic privileges. Ross, however, apparently deeming such services and privileges insufficient to obtain such listed business, offered more; he also offered reciprocal business which, unknown to the broker-dealers he had fraudulently created. The scope of an employee's employment encompasses not only acts actually authorized by the employer but encompasses also forbidden and tortious acts which are employed by the employee in order to accomplish the result for which he was employed. The Restatement of Agency states the rule as follows:

"§230. Forbidden acts

An act, although forbidden, or done in a forbidden manner, may be within the scope of employment."

"§231. Criminal or Tortious Acts

An act may be within the scope of employment although consciously criminal or tortious."

Thus in *Martin v. Leatham, supra,* 22 Cal. App. 2d at 444-445, the court stated:

" 'It is the general doctrine of the law, as it is our statutory rule, that a principal is liable to third parties not only for the negligence of its agent in the transaction of the business of the agency, but likewise for the frauds, torts or other wrongful acts committed by such agent in and as part of the transaction of such business. (Story on Agency, sec. 452; Shearman & Redfield on Negligence, sec. 65; Civ. Code, sec. 2338.)' ". . .

'The rule is elementary that a master is responsible for the acts of his servant done in the course of his employment, even though those acts be unauthorized or contrary to the master's explicit instructions. As between the master and third persons, the acts of the servant done as a part of the doing of that which he is employed to do are as it done by the master himself, *and the question of authority* as between the master and servant to do the particular acts is quite immaterial.' "

Likewise, in *Moynes v. Applebaum, supra,* 187 N.W. at 242, the court stated:

". . . The main question raised by defendants' counsel is the right of plaintiffs to recover from defendants in an action of fraud and deceit for the fraudulent representations of their agents where defendants had no knowledge of such representations and such representations were not authorized by them. We are persuaded that this court has settled this question adversely to the contention of defendants' counsel. . . . The son, Harry, was the agent of his father in making the sale. In selling the property he was acting within the scope of his authority. In making the sale he made certain representations. These were the instrumentalities used by him in his principal's business and for his principal's benefit, and they thereby became the instrumentalities of the principal. He cannot reap the harvest and refuse to pay for the seed."

III.

A Victim of a Fraud Which Involves the Successful Victimization of a Number of Persons Arranged in a Chain Transaction Is Not Required to Proceed Against the Prospective Victim Following Him in the Chain Before Proceeding Against the Persons Perpretrating Such Fraud.

Appellants contend that before appellee may proceed either against Kamen & Co. or against Ross and Grossinger[15] he must first proceed against the persons who were fraudulently induced to buy the stock from appellee. This is undoubtedly the first case in history where a defrauding party has come into court and stated "you have not been damaged because by repeating my fraudulent acts I can (or have) found you a buyer." Under this theory, all of the defrauded parties would sue each other while Kamen & Co., Ross and Grossinger watched and smiled.

It goes without saying that this is not the law. Defendants cite the case of *Gulke v. Brock, 222* Cal. App. 2d 459, 460 (1963) for the proposition that "naturally, where plaintiff has been induced by fraud to purchase stock or other property but has sold or can sell that property for a sum in excess of or at least equal to the amount to be paid, he can recover no damages from the defendant." (App. Br. p. 31.) This case merely states the California "out-of-pocket" damages rule which provides that a defrauded party can only recover the difference between the price paid and the *actual value* of the property received. In that case an appraisal

[15]Appellants' argument that appellee has not suffered any damage would of course apply equally to the liability of Ross & Grossinger.

showed that the value of the property received equalled the purchase price.

If a defrauded party resells the property purchased by him, such sale would be evidence of the actual value or the fair market value of the property but it would not be conclusive as to either such values. (*Chicago Corp. v. Munds,* 172 Atl. 452 (Del. 1934).)

The very cases cited by defendants support the foregoing rule. Thus, in *Freeman v. F. P. Harbaugh Co.,* 114 Minn. 283, 130 N.W. 1110 (1911), the court held that plaintiff's damages were *not* the difference between what plaintiff paid for certain notes and the sale price of such notes when plaintiff later disposed of them. The court stated that the sale price was only evidence of the market value of the notes and that the correct measure of damage was the price paid by plaintiff for the notes minus the market value thereof. Of course, in considering market value, the solvency of the maker and the property securing the notes must be considered.[16]

[16]The remaining cases cited by appellants are distinguishable on the same basis. Thus in *American Nat. Bank v. Hammond,* 25 Colo. 367 (1898) plaintiff was induced to sell merchandise to an insolvent purchaser by reason of the misrepresentation of a bank employee. The plaintiff sued the bank. The court held that plaintiff's damages was the market value of the goods, minus the amount of cash plaintiff had actually received from the purchaser for the merchandise. Plaintiff's damages were not reduced by the value of any cause of action against the purchaser.

Likewise in *Hamlin v. Abell,* 120 Mo. 188, 25 S.W. 516 (1893), the court ruled that evidence of the insolvency of an endorser of a note was properly admitted to show damage to plaintiff who was induced to purchase such notes by fraudulent representation of defendant. Again, this is consistent with establishing the market value of a note. The only way one can determine the value of a note is to look to the likelihood of being paid by the maker or endorser.

In this case plaintiff has proved that the market existing at the time of plaintiff's aborted sales was manipulated. Appellants stipulated that after the manipulation ceased, the stock was worthless. Under such circumstances the evidentiary value of appellee's sales is equal to the stipulated value of the shares, *zero.*

Appellee does not, however, desire to deprive Kamen & Co. either of the Jerome Richard stock now owned by it or of its cause of action against the purchasers. Consequently it has deposited both the stock certificates and an assignment of its causes of action, if any, with the court. [R. T. 365, 461.] Appellee hereby agrees that appellants may withdraw these papers upon satisfying the judgments against them.

IV.

A Member of the Securities Industry Has a Non-Delegable Duty to All With Whom He Deals to Deal Honesty and Fairly.

Regardless of any question of the scope of Ross's employment, or the apparent authority vested in him, Kamen & Co. is liable because as a licensed broker-dealer under the Exchange Act of 1934, it was under a non-delegable duty not to violate any of the provisions of the Securities Exchange Act of 1934, either through its employees or otherwise. (Rest. of Agency §214; *United States v. Armour & Co.,* 168 F. 2d 342, 343-344 (3rd Cir. 1948); *Hudson v. Nixon,* 57 Cal. 2d 482, 484 (1962); *Snyder v. Southern Cal. Edison Co.,* 44 Cal. 2d 793, 798-799 (1955); *Taylor v. Oakland Scavenger Co.,* 17 Cal. 2d 594, 604 (1941); *Luce v. Holloway,* 156 Cal. 162, 163-166 (1909).

Restatement of Agency §214 states:

"Failure of Principal to Perform Non-delegable Duty. A master or other principal who is under a duty to provide protection for or to have care used to protect others or their property and who confides the performance of such duty to a servant or other person is subject to liability to such others for harm caused to them by the failure of such agent to perform the duty."

Comment b. thereunder provides, in part,

"*Action illegal unless licensed.* When a license is required for the performance of acts, one having a license who delegates performance of the acts to another is subject to liability for the negligence of the other . . ."

Comment e. thereunder provides,

"*Voluntary relations.* A master or other principal may be in such relation to another that he has a duty to protect, or to see that due care is used to protect, such other from harm although not caused by an enterprise which has been initiated by the master or by things owned or possessed by him. This duty may be created by contract, as where one agrees to protect another, or may be imposed by law as incident to a relation voluntarily entered into, as the relation of carrier and passenger, or by statute. A statement of the situations in which a duty of this sort exists and of the limits of such duty is beyond the scope of the Restatement of this Subject. In situations coming within the rule stated in this Section, the fact that the one to whom the performance of the duty is

> delegated acts for his own purposes and with no intent to benefit the principal or master is immaterial."

Thus, in *Hudson v. Nixon, supra,* 57 Cal. 2d at 484, the court held the principal liable for her agent's violation of the Hawkins Civil Rights law without any showing of authority or personal fault of the principal. Likewise, in *Snyder v. Southern Cal. Edison Co., supra,* 44 Cal. 2d at 798-799 a public utility was held liable for an *independent contractor's* negligence in installing power poles on the principle that the installation of such poles, according to law, is a non-delegable duty imposed on the utility. In *Taylor v. Oakland Scavenger Co., supra,* 17 Cal. 2d at 604 (1941) the court also held the defendant liable for the negligence of an independent contractor. The court stated:

> "If, however, an individual or corporation undertakes to carry on an activity involving possible danger to the public under a license or franchise granted by public authority subject to certain obligations or liabilities imposed by the public authority, these liabilities may not be evaded by delegating performance to an independent contractor. The original contractor remains subject to liability for harm caused by the negligence of the independent contractor employed to do the work." (Accord *Luce v. Holloway, supra,* 156 Cal. 162, 163-169 (1909).)

In *United States v. Armour & Co., supra,* 168 F. 2d at 343-344, the court expressed the rule as follows:

> "It appears that appellant's main office had repeatedly cautioned against such conduct, but this corporation, one extremely large in the vital food in-

dustry, cannot evade its responsibility by referring to its elaborate interbranch correspondence and its instruction meetings. Seventeen violations of the tie-in sales prohibition in three out of a total of five branch houses in the Philadelphia area point to a condition prevailing of which it was the employer's duty to be aware. The checking and elimination of such obviously illegal practices is not shown to have been any more difficult than other details of a nation-wide industry. The employer 'does not rid himself of that duty because the extent of the business may preclude his personal supervision, and compel reliance on subordinates. *He must then stand or fall with those whom he selects to act for him.* He is in the same plight, if they are delinquent, as if he had failed to abate a nuisance on his land. * * * *It is not an instance of respondeat superior. It is the case of the non-performance of a nondelegable duty.*'" (Emphasis ours.)

Kamen & Co. was required to obtain a license before being permitted to engage in the business of a security broker. (Securities Exchange Act of 1934, § 15(a), 15 U.S.C.A., § 780(a).) The whole purpose and design of the Securities Act of 1933 and the Securities Exchange Act of 1934 was to protect investors against the fraudulent conduct that was rampant in the securities industry. The industry at that time was deemed to create a severe risk to the general public. (Securities Exchange Act of 1934, §2, 15 U.S.C.A. 78(b).)

The business conduct of a broker-dealer therefore comes squarely within the above-cited cases. There is imposed on each broker-dealer a non-delegable duty to

prevent a violation of the Securities Act of 1933 and the Securities Exchange Act of 1934 in any business dealings in which his firm takes part. The liability of a broker whose employees violate the Acts is not a vicarious one, it is imposed directly on the broker because of the duty imposed upon him to protect the public.

V.

The Standard of Care Imposed by the Trial Court on New York Stock Exchange Member Firms for the Supervision of Their Employees Failed to Conform to Current Standards and Is Reminiscent of a Rejected Era in the Securities Industry.

Restatement of Agency § 219(2)(b) provides:

> "A master is not subject to liability for the torts of his servants acting outside the scope of their employment unless
>
> (b) the master was negligent. . . ."

The broker-dealer division of Kamen & Co. earned more commissions during its operations than all of the other employees and all of the partners combined. At the time these commissions were being generated by Ross, there was a general custom in the securities industry which provided for the exchange of "give up" or "reciprocal business" for listed commission business. Yet Mr. Kamen bought the incredible story that Ross, with less than 18 months in the securities business, could obtain the listed business controlled by over-the-counter dealers without giving any reciprocal business. Mr. Townsend stated he would not buy such a story. [R. T. 362.] Mr. Kamen, however, not only bought the story but also accepted Ross' word that he could bring

in considerably more business than all of the eight long-time employees and two partners of Kamen & Co. combined. Moreover, he accepted Ross' word that this could be accomplished by providing such services as collect long distance phone calls for quotations on stocks[17] and furnishing Carl Loeb, Rhoades research material. Mr. Townsend and Mr. Bailey stated that the research bulletins were readily available [R. T. 295, 340] and Mr. Bailey testified that to call collect to New York to obtain the price of a stock is an "especially poor" service and would be "impossible." [R. T. 245, 300.]

What were the duties imposed by the Securities Act on Kamen & Co. at this juncture? Did Kamen & Co.'s duties at the very least require the company to appoint a partner or supervisory employee to work with Mr. Ross on this very important project or to place a partner or other supervisory employer in close proximity to Mr. Ross while he was soliciting the over-the-counter business? Such an employee sitting next to Mr. Ross in the one room occupied by Kamen & Co. in the early part of 1963 could have overheard the Jerome, Richard "give-ups" even though Mr. Kamen, separated by a banister, was not able to do so. Likewise, a partner or supervisory employee with a desk in Ross' special room could have prevented the fraud here involved. The Securities Act of 1933, the Securities Exchange Act of 1934 and the common law clearly impose that much responsibility on a firm which is a member of the New York Stock Exchange and the National Association of Securities Dealers. If the vastly reduced standards ob-

[17]Mr. Kamen admitted that brokers frequently have direct lines to New York Stock Exchange firms located in their city and Mr. Bailey testified that it would be extremely rare for a broker-dealer not to have such a direct line. [R. T. 253, 298.]

viously applied by the trial court are all that are required the responsible members of the securities industry will be able to avoid liability for their employees' frauds, no matter how much they benefited therefrom and no matter how much such fraud required the use of the members' facilities and the members' association with the New York Stock Exchange or National Association of Securities Dealers. Such liability could be avoided by the member as long as he is not actually involved in the fraud and can escape knowledge thereof for a period as long as seven months. Such standard of care will revert the securities industry to the jungle of a bygone era.

VI.

The Trial Court Erred in Refusing to Admit the Certified Affidavit of Francis J. Donnelly.

At the trial, appellee requested that plaintiff's Exhibit 52, an affidavit by an S.E.C. investigator regarding his investigation into the Jerome Richard's fraud be admitted into evidence. That affidavit contained a complete history and description of the fraud including its vast scope and the number of victims involved. The affidavit stated that more than 100 broker-dealers took part in the reciprocal business transactions (Paragraph 19), moreover, the affidavit contained the important statement that when Thomas S. Crowe, a broker-dealer located in New York, complained to Mr. Kamen that he was not getting enough reciprocal business, Mr. Kamen stated to Crowe that he would "speak to the boys about it" (Paragraph 39). Much of the information in the affidavit was obtained by the Securities and Exchange Commission by inspection of

books, records, and other documents. Of course the aforementioned statement by Kamen was obtained through an interview of Mr. Crowe. The trial court refused to admit the affidavit [R. T. 549]. It even refused to read the affidavit in order to exercise its discretion on whether to admit the document. [R. T. 547].

The affidavit was prepared by Mr. Donnelly, an investigator for the S.E.C. pursuant to the statutory obligation of the Securities and Exchange Commission to investigate possible violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 (15 U.S.C.A. §§78(a) and 78(u); *Schmidt v. United States*, 198 F.2d 34 (7th Cir. 1952); *Boehm v. United States*, 123 F.2d 791, 801 (8th Cir. 1941).

Rule 515 of the American Law Institute Model Code of Evidence provides:

"Rule 515. Written Statements by Public Officials.

Subject to Rule 519, evidence of a writing made as a record, report or memorandum of facts and conclusions concerning an act, event or condition, unless specifically priviledged from disclosure by a statute requiring it to be made, is admissible as tending to prove the truth of the matter stated therein if the judge finds that

(a) the writing was made in the performance of the functions of his office by an official of a state or nation or governmental division thereof, acting personally or through his subordinates, and

(b) it was a function of the official acting personally or through his subordinates

(i) to do the act, or

(ii) to observe the act, event or condition, or

(iii) to investigate the facts concerning the act, event or condition and to make findings or draw conclusions about it."

The comments to such Rule state:

"a. Comparison with existing law. This Rule goes beyond the common law, for it admits statements as to matters not within the knowledge of the reporter or of the recorder. . . ."

This Rule is accepted by the 2nd, 6th, 3rd and 10th Circuits. (*E. K. Hardison Seed Co. v. Jones*, 149 F.2d 242, 256-257 (6th Cir. 1945) [expressly holding that the results of an officer's investigation are admissible even though the officer does not have first-hand knowledge of the facts]; *Pittsburgh-Des Moines Steel Co.*, 183 F.2d 467, 473 (3rd Cir. 1950) [holding that the inclusion of hearsay in report goes to the weight, not the admissibility of such report]; *Hunter v. Derby Foods,* 110 F.2d 970, 972-973 (2nd Cir. 1940); *Franklin v. Skelly Oil Co.*, 141 F.2d 568, 572 (10th Cir. 1944) [investigative document of fire marshal held admissible but trial court did not abuse its discretion in refusing to admit the document].

In *Oleander v. United States*, 210 F.2d 795, 800 (9th Cir. 1954) this court apparently rejecting the Model Code of Evidence and the authorities cited above,

made a distinction between official records where the author had personal knowledge of the facts and official records where such knowledge was obtained by investigation. The court stated that the latter documents were not admissible. The *Oleander* case has been sapped of much of its vitality by *Canada Life Assurance Company v. Houston,* 241 F.2d 523 (9th Cir. 1957). (See also: *LaPorte v. United States,* 300 F.2d 878, 881 (9th Cir. 1962).) Thus in *Canada Life Assurance Company v. Houston, supra,* this Court held that the verdict of a coroner's jury, clearly a document where the authors did not have first-hand knowledge of the facts, was admissible evidence.

The affidavit of Francis J. Donnelly was prepared by an impartial official, in the exercise of his official duty. These attributes alone would normally be enough to render the document sufficiently trustworthy to permit its admission into evidence. The affidavit of Mr. Donnelly, however, was also under oath therefore adding this additional safeguard. Had the trial court admitted Exhibit 52, it would have obtained the important information concerning the conversation between Crowe and Kamen which clearly indicates that Kamen well knew that his employees were giving reciprocal business of some nature even if he did not know the exact nature of the fraud being perpetrated. Mr. Kamen, of course, would also have had to know that the business was artificially generated since he testified that he had very little over-the-counter business. [R. T. 256.]

The affidavit also contained a large amount of information gathered by Mr. Donnelly first hand. For example the number of brokers involved [¶ 19] (bearing upon the reasonableness of the reliance), the fact

that part of the commission of Ross and Grossinger were shared with Perotta and Ginsberg [¶ 16][18] as well as other important investigatory information such as the extended presence of Herman at Kamen & Co.'s office even though Herman was not an employee. [¶ 19.]

The trial court's failure to admit this affidavit or at least to exercise its discretion[19] as to whether such document should be wholly or partially admitted was error.

Respectfully submitted,

ROSENFELD, MEYER & SUSMAN,
GARY A. SCHLESSINGER,
Attorneys for Appellee.

[18]The payment of part of the commissions of Ross and Grossinger to Perotta and Ginsberg, who were not registered representatives of course violates the New York Stock Exchange anti-rebate rule.

[19]The trial court did not exclude the report in the exercise of its discretion, since it refused even to read the report [R. T. 547.]

Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

GARY A. SCHLESSINGER

APPENDIX A.

"EXCERPTS FROM REPORT OF SPECIAL STUDY OF SECURITIES MARKETS OF THE SECURITIES AND EXCHANGE COMMISSION, PART 2".

2. STRUCTURAL ASPECTS OF THE PUBLIC RATE SCHEDULE

This section singles out certain aspects of the structure of the public or nonmember commission rate schedule because of their distinctive repercussions not only upon public customers but also on professionals in the securities business who are not members of the NYSE, on the regional exchanges and their members, and on both mutual funds and their shareholders. The next section examines structural aspects of the members' rate schedules. While these structural aspects involve issues of basic importance, many of which have been the subject of numerous studies and differences of view within the Exchange community, they have only in limited respects received the formal attention of the Commission.

a. Nonmember professionals pay the same rate as other customers

Under the public commission schedule of the NYSE, a nonmember broker must pay a member the same commission that his customer would pay if he were to place the order directly with a member. Yet the nonmember incurs, in addition to the commission cost, overhead and other expenses incident to securing and transacting the business. Since competition normally prevents the nonmember from charging his customer any more than the rate charged by a member, his gross income from the transaction generally equals the commission he pays to the member, notwithstanding his other costs. Yet unless he accepts such NYSE business placed with him by his customer, he runs the danger of losing both customer and business altogether.

Such business is important to the NYSE. Its studies conducted between 1952 and 1960 show orders from nonmember brokers to the NYSE for public individuals, institutions, and others accounting for 11 to 24.3 percent of total share volume effected for the account of

[545] A provision of the original bill (sec. 18(c) of S. 2693, 73d Cong., 2d sess.) empowered the Commission to fix rates directly, just as it was authorized to deal directly in most of the other areas now covered by sec. 19(b). When the present machinery of sec. 19(b) was substituted, no attention appears to have been given, at least on the record, to its impact on the review of commission rates.

institutions and intermediaries, which during this period represented about 20 percent of the Exchange's total volume.[546] Such transactions at full commission rates are obviously profitable to the NYSE member, and there is incentive for him to make it attractive for the nonmember professional to forward it to him. But the constitution of the Exchange provides that commissions paid to the member shall be—

> * * * net and free from any rebate, return, discount or allowance made in any shape or manner, or by any method or arrangement, direct or indirect.[547]

Member and nonmember must then devise some other means of both reimbursing the nonmember and attracting the business to the member. Attempts to bypass this NYSE antirebate provision have been the single most important cause of the development of what are generally referred to as "reciprocal business arrangements" and "special" services among member and nonmember firms.

(1) *Reciprocal business arrangements*

The member desiring to reciprocate for commission business given him by a nonmember professional can do so by returning commission business to the nonmember. There are several methods, only the most important of which can be mentioned here: he may place business on a regional exchange with a nonmember who is a member of that exchange even though (a) the member is also a member of the regional exchange (dual member) and could have placed the business there directly or (b) the security is traded on the NYSE as well as the regional exchange (dual listing) so that the dual member could have effected the transaction directly on the NYSE. He may place orders for unlisted securities with the nonmember to be transacted over the counter, even though the member firm may have a trading department capable of effecting the transaction directly. This reciprocal commission business is generally placed under arrangements involving "reciprocal ratios" of 2 to 1, 3 to 1 or similar ratios; that is, the NYSE member will direct $1 in commissions to the nonmember for each $1.50, $2, or $3 of commissions received.[548] The ratio always favors the NYSE member.[549]

A variation of the basic type of reciprocal commission arrangement is cited in the testimony taken by the Special Study of a partner in a member firm of both the NYSE and the Philadelphia-Baltimore-Washington Exchange and himself an active specialist on the latter exchange. Many of the firms which are members of the regional exchange but not of the NYSE give this firm orders to execute on the NYSE. When asked what his firm gives, by way of reciprocity, to such regional members, the partner answered:

> A. We eventually will give that man clearance[550] to the extent, we will say, of roughly 50 percent. It would not be in excess of that. That will net him about 40 percent, after he pays floor brokerage and clearance charges.
>
> Q. What kind of clearance business will you give him? Where will it come from?
>
> A. If Laird, Bissell & Meeds [an NYSE member firm] will sell us 500 General Motors, instead of giving up our name on the transaction we will give up the name of a local member to whom we wish to give clearance business.

[546] NYSE, "Ninth Public Transaction Study," p. 11 (1959); "Tenth Public Transaction Study, Pt. II," p. 10 (1960).
[547] NYSE constitution, art. XV, sec. 1.
[548] See pt. E of ch. VIII.
[549] Apparently as a result of reciprocal arrangements of all kinds, one nonmember firm advised the study that despite the antirebate provisions of the NYSE constitution the firm ultimately receives in return the equivalent of approximately 40 percent of the commission on NYSE business forwarded to member firms.
[550] The term "clearance" here seemingly refers to both execution and clearance of a transaction.

If a bank, for instance, gave us 500 Pennsylvania Railroad to sell, we would give up the name of some local broker on that transaction. He would act as clearance agent on that. Therefore, it would come both from firm trading and from customer business.

Q. What is the ratio here?

A. I do not know, possibly 60 to 40; 60 percent firm and 40 percent customer, in our case. In other cases it might all be the customers.

Upon first impression, one might regard a practice such as this as typical of reciprocity in many industries in which a firm reciprocates for orders from a customer by placing business with him for goods or services it cannot provide itself. Thus, securities commission firms commonly receive brokerage business on a reciprocal basis from commercial banks in which they maintain sizable accounts.[551] There is a fundamental difference in reciprocal commission arrangements between brokers, however, because the NYSE member is generally able to handle directly, and at least as effectively, the business he places with his reciprocal partner.

The extent of these reciprocal commission arrangements is revealed in the returns to the Special Study's questionnaire EX–4. Of 447 members of the four largest regional exchanges not members of the NYSE (i.e., "sole members"), 298 reported participation in such arrangements in ratios ranging up to 3 to 1, but with 2 to 1 most popular. Of the 285 members reporting on the income received from such arrangements, 41 attributed to them at least 40 percent of their income, and 175, or 61 percent, attributed a minimum of 20 percent of their income to this source. (Tables VI–z to VI–bb.)

TABLE VI–z.—*Number of sole regional exchange members having reciprocal arrangements*

Exchange	All members	Members with reciprocal arrangements	Members with no reciprocal arrangements
Total	447	298	149
Boston	29	6	23
Midwest	233	149	84
Pacific Coast	78	59	19
Philadelphia-Baltimore	107	84	23

TABLE VI–aa.—*Nature of reciprocal arrangements of sole regional exchange members*

[Number of members]

Reciprocity ratio (regional members to NYSE members)	Exchange				
	All members	BSE	MSE	PCSE	PBSE
Total	[1] 280	5	137	57	81
1 to 1	7		3	2	2
1½ to 1	2				2
2 to 1	203	3	85	50	65
2½ to 1	36	2	28	2	4
3 to 1	32		21	3	8

[1] Excludes 18 members who have reciprocal arrangements but did not furnish complete information

[551] See ch. VIII.C.4.c.

TABLE VI–bb.—*Proportion of total exchange income received from reciprocal business by sole regional exchange members*

[Number of members]

Ratio of income from reciprocal business to total exchange income (percent)	Exchange				
	All members	BSE	MSE	PCSE	PBSE
Total	[1] 285	6	139	59	81
0.1 to 10.0	52	2	19	18	13
10.1 to 20.0	58	1	28	13	16
20.1 to 30.0	88	1	45	14	28
30.1 to 40.0	46		26	11	9
40.1 to 50.0	18	1	12		5
50.1 to 60.0	14		5	2	7
60.1 to 70.0	5		2		3
70.1 to 80.0	2	1	1		
80.1 to 90.0					
90.1 to 100.0	2		1	1	

[1] Excludes 13 members who engage in reciprocal business but did not furnish complete information.

Return by an NYSE member of cash to his reciprocal correspondent for commission business would violate the antirebate rule cited above, but the return of a cash equivalent in the form of profitable security commission business which might have been transacted directly by the NYSE member is permissible. The distinction is obviously a fine one and it has produced a fertile field for administrative interpretation. The Exchange's published constitution and rules have never officially recognized a need to regulate reciprocal commission arrangements. Its rule 369 outlaws 10 specific commission practices either outright or under specified conditions, but does not mention reciprocal arrangements with nonmember professionals. An NYSE interstaff memorandum illustrates that the problem is present and is a perplexing and demand one:

> **In general, the Exchange does not object as a matter of policy to the existence of reciprocal arrangements, per se, even when they are based upon a ratio, such as 2 for 1, 1 for 3, etc., provided any business directed to the nonmember is bona fide business, and does not involve so-called "generated" business or "allocated" trades, and further provided any ratio is not guaranteed and no deficiency in the amount of business given by the member to the nonmember is paid or made up in cash. If a member firm has a well-organized and well-staffed department for handling, as an example, over-the-counter business, the Exchange probably would object to that firm's directing all of its over-the-counter business to a nonmember under a reciprocal arrangement.**

Testimony to the Special Study by NYSE staff officials Frank Coyle and Walter Coleman served to point up the problems of interpretation. Coyle and Coleman confirmed that the first sentence in the quoted paragraph still represents the policy of the Exchange. They noted that an "allocated" trade "would be a transaction which is a bona fide trade but, as an example, might have been executed by me as a broker and I would give bookkeeping credit to someone else for having executed when in fact they would not." An example of "generated business" was given by Coleman as "* * * a transaction which I originate as principal, not as customer. I might as a broker give you an order for which I had no particular need." Coyle defined the term as "an order created solely for the purpose of paying you a commission for executing it in a stable security where the risk is not high and where I would reverse the transaction again giving you another com-

mission." The witnesses were asked "* * * does it matter if the ratio is a firm one or not?" and the testimony proceeded as follows:

A. [By Coyle] To my way of thinking it makes no difference at all what the ratio is. If the reciprocity is merely on a business basis that I give you business because I think you can execute it, and I hope you give me business for the same reason, and we will try to keep even with each other, and so long as I have sufficient on your exchange to match what you give me on my exchange, and the rates I pay for that are proper, I see no objection to it whatever.

Q. The paragraph goes on to say that if a member firm has a well-organized and well-staffed department for handling, say for example, over-the-counter business, the Exchange probably would object to that firm directing all of its over-the-counter business to a nonmember under a reciprocal arrangement. Is that the present policy of the Exchange?

A. Well, I have got to add a little explanation with it, yes, with this explanation. By agreeing to give all your business in over-the-counter securities to one broker, you may not be servicing your customers properly because he may not properly cover the waterfront. An unlisted market is not the same as a listed market where there is a central point and policies, and records of the transaction. We think it is the duty of the broker to do the best for his customer and by promising to give all the business to one person willy-nilly might violate that.

* * * * * * *

Q. The policy refers to a "well-organized and well-staffed department." How many member firms of your Exchange meet this test, percentagewise?

A. Again you are reading from a memorandum, an interstaff memorandum, which was not written with the idea that it was going to be a legal matter for all time and it is one member of the staff telling another member of the staff in general terms broad policy. I think I would have to get a definition from you as to what you mean by a well-organized and completely staffed department to answer your question as to how many firms have them.

The complexity of the problem becomes apparent. Reciprocity arrangements representing "generated" or "allocated" business violate the antirebate rule; reciprocal business based on the member's "hope" that he can secure return business is legitimate. The arrangements referred to above actually fall somewhere between the extremes. The member normally directs business to his reciprocal correspondent with something more than "hope" that his correspondent will reciprocate. Members' reports of such agreements filed with the Midwest Exchange under its commission rules indicate the firmness of the understanding on which they are founded. This general recognition of the existence of reciprocal ratios elevates the basis of these arrangements from the level of "hope" to that of reasonable expectation based on informal agreement, often crystallized by years of business relationship and always subject to the sanction of cancellation if the correspondent fails to maintain the agreed ratio.

The NYSE's task of policing the antirebate rule in this field extends beyond its own floor. Because its members often discharge their reciprocal obligations by placing business with reciprocal correspondents for transaction on the regional exchanges, the question is presented concerning the Exchange's power to prohibit a member from engaging in a practice permissible under the rules of a regional exchange but constituting a rebate under its own rules.

A prime example of this conflict is the problem discussed at a Toronto meeting of top officers of the NYSE and the presidents of some of the regional exchanges in October 1952. At issue was the question of the amount of the commission to be paid by a dual member to a regional-only member on reciprocal business. At that time most of the regional exchanges either provided that the member "execu-

tion and clearance" commissions might be "mutually agreed" between members of the particular exchange, or else prescribed minimum rates of 25 percent of the nonmember rates. Dual members, however, were voluntarily paying more than 25 percent for the execution and clearance of business which they directed to regional members in return for NYSE orders received from such members. In many cases they paid the full nonmember rate.

Although such practices were permissible under the rules of the regional exchanges, the NYSE opposed them, arguing that, as a member of the regional exchange, the NYSE dual member was entitled to execution and clearance at the regional member rate of 25 percent, and any payment in excess of that figure constituted a rebate of commissions received on NYSE business placed with him by the regional member. The regional exchanges initially emphasized their exclusive jurisdiction in setting their own internal rates. The Toronto meeting resulted in a compromise arrangement under which most of the regional exchanges either increased their minimum execution and clearance commission to 50 percent of the nonmember rate, or continued to allow each member to set his own execution and clearance rate, with an understanding in both cases that no dual member would be charged more than 50 percent of the nonmember rate if he did any NYSE business with the regional member. This compromise was described in an NYSE memorandum as " * * * an informal but nonetheless binding commitment to us * * * " that the regional exchanges would not permit dual members engaged in reciprocal business with regional members to pay "anything in excess of 50 percent of the full nonmember rate."

At first the Boston (BSE), Pittsburgh, and Cincinnati exchanges refused to accept this arrangement, but by 1954 only Boston remained as a holdout. The BSE's position caused the NYSE considerable embarrassment, as interoffice memorandums and correspondence reveal. The matter was apparently formally closed in May 1962, when Boston apparently finally accepted the 50-percent arrangement.

Coyle was asked to explain the basis for the acceptance of the 50-percent rate as a dividing line between permissible commissions and rebates.

Q. Did your department inquire into whether the 50 percent represented a reasonable compensation for [execution and clearance]?

A. Yes.

Q. What was the conclusion?

A. The conclusion was that we were leaning over a little bit to accept that as the reasonable cost of doing such business.

Q. Well, was this 50 percent a negotiated figure between your Exchange and regional exchanges?

A. I don't know.

Q. Well, under what circumstances did you make such a study or give consideration as to whether 50 percent was a reasonable arrangement?

A. Well we related it to the known arrangements on our own Exchange where out-of-town member firms, correspondents of New York firms, had such work done for them and a great deal more, including the transportation of business from out-of-town to New York on a costly private wire, and that they were doing that for, as I said, from 27 to 40 percent.

Q. But here the local member on the regional Exchange is receiving 50 percent without providing any of the services which were in fact being borne by the New York member?

A. That's right.

Q. So that the 50 percent then would represent more of a difference between 40 and 50 percent than would appear on the surface?
A. That's right.

* * * * * * *

Q. Was it your judgment that this did or did not involve a rebate, this 50-percent figure?
A. I wouldn't say it involved a rebate. I think it showed the development of a loophole by which the donors of New York Stock Exchange business could find an avenue of return income within and with the help of rules of other exchanges of which they were members.
Q. Was it your judgment that they have successfully found such a loophole?
A. I don't think I have an opinion.
Q. Well, you do agree that the 50-percent figure [when considered], with the other services [provided by the dual member for the nonmember firm], is far in excess of the [execution and clearance] figures that prevail on your own floor.
A. Obviously.

The drive to circumvent the strict terms of the NYSE nonmember commission rate schedule may be illustrated by another practice known as a reverse transaction. In this situation the NYSE member seeks to reward the nonmember for business received not by returning commission business but by effecting the nonmember's transaction at a cost less than the commission rate. One form of this practice is set forth in an Exchange memorandum outlining a so-called arbitrage operation which involved the NYSE and the Midwest Stock Exchange.

Mr. Thomas Kohler, a specialist on the Midwest Stock Exchange, who also acts as floor broker for Scherck, Richter & Co., sits right next to the teletype machine of [the NYSE member firm of] Vilas & Hickey on the Midwest floor. Other specialists who want to buy stock on the NYSE to offset their specialists positions go to Mr. Kohler if he is available, and merely say "buy 100 Steel" or something comparable, and it is tacitly understood that Mr. Kohler will give that order to the Vilas & Hickey telephone operator, who transmits it to New York. Vilas & Hickey buys for its own account on the NYSE 100 shares of Steel, or whatever the order calls for, and wires back, via the teletype wire to the Midwest floor, instruction to sell the same stock to the Midwest specialist who placed the original buy order. In the case of low or medium priced stocks, this is done at an automatic markup of ⅛ point over the actual cost on the NYSE. In the case of some high-priced stocks, the markup is ¼ point.

In a few cases, when the Midwest specialist introduces his buy order through Kohler, or in Kohler's absence, directly with the teletype operator of Vilas & Hickey, a price is specified. In most cases, however, no price is specified and it is tacitly understood that Vilas & Hickey will buy for its own account at the market in New York and sell on the Midwest at a markup of ⅛ or ¼ point.

It is very fast wire, and according to Mr. Hosty there is a steady stream of orders going over the wire all day long. Further, according to Mr. Hosty, practically everyone on the Midwest Exchange knows that the purpose of the arrangement is not to conduct an arbitrage, but, rather, to enable specialists and floor traders or floor brokers on the Midwest Exchange to get New York executions for less than the nonmember commission.

The NYSE required the member firms involved to discontinue the practice and subsequently denied a request by the Midwest Stock Exchange to allow the practice. Its occurrence demonstrates, however, the motivations created by a commission schedule which treats essential business transactions of nonmember professionals in the security commission business the same as ordinary transactions of the public generally.

(2) *Special services arrangements*

Subject to the vaguely adumbrated exceptions discussed above, the NYSE member may thus reward a nonmember professional for securities business by reciprocating commission business on an agreed

ratio without violating the antirebate rule. He may also accomplish the same objective, within certain limitations, by furnishing his correspondent with special services: installation and maintenance of wire services,[552] clearance of non-Exchange transactions,[553] office space,[554] special research, and promotional materials and displays.[555]

Once more the interpretation is a delicate one. Section 2.c, below, describes how the nonmember commission rate covers many services incident to the brokerage business in addition to the execution and clearance of a transaction. Most of these services for public customers are generally not required by a professional in the securities business. But because the nonmember professional receives no discount under the existing nonmember schedule, the NYSE member can correct this apparent inequity and, at the same time, tangibly acknowledge his appreciation for securities business directed to him by furnishing the nonmember with special services he does need.

Consistent application of the antirebate rule would seem to require an interpretation prohibiting special services costing more than services rendered to other customers generally. Once again the distinction poses some fine administrative questions. They may be illustrated by the practice of maintaining private wires between the offices of a member and nonmember in order to service the nonmember's business transacted with the member. The practice is generally permissible, but where the nonmember also uses the wires for communication with his own branch offices or with another nonmember, the rules require him to contribute toward the cost "in proportion to his use thereof with a minimum of 10 percent." This refinement aside, a member may incur unlimited expense in maintaining such wires as long as they are used to service the nonmember's business with the member. It would, however, be a rare coincidence if the cost of such wires turned out to approximate the cost of value of normal services to investors generally included in the commission rate.

Another special service of NYSE members to nonmember professional customers is the clearance without charge of nonexchange transactions. Although the NYSE does not purport to prescribe commissions for such transactions, the Exchange has interpreted the "no rebate" provision to prevent members from reciprocating for security commission business on the NYSE by clearing regional exchange or over-the-counter transactions free of charge. The problem again proved vexing, however, when the Exchange's interpretation of the antirebate rule collided with a regional exchange's application of its own commission rules. An NYSE departmental memorandum of March 1954 noted that dual NYSE-Boston members with clearing facilities in Boston were clearing BSE transactions for BSE members free of charge in return for NYSE business received from such BSE members. It added that "Mr. Besse, president of the Boston Stock Exchange, has told us that this has been standard practice for the past 30 years." No action was taken on the matter until 1960, when Coyle, in a memorandum to NYSE President Funston, noted in part:

In the Philadelphia, Chicago, and West Coast Exchanges our members make charges for handling any clearance business for specialists on those exchanges.

[552] NYSE rule 359; NYSE Guide, par. No. 2359.10.
[553] NYSE Guide, par. No. 2381.18.
[554] NYSE rule 344; NYSE Guide, par. No. 2344.11.
[555] NYSE Guide, par. No. 2440A. See ch. XI.

The charges are not uniform in all the regional exchanges, but they are based on a per-share item charge. In Boston, however, for many years a few member firms have not charged anything at all for clearing transactions—primarily odd lots—for certain Boston specialists.

We propose to tell each of the member firms in Boston presently doing such clearance on a "love" [free] basis that the Exchange expects that some charge be made—a per-share charge that will at least cover out-of-pocket expenses. This is entirely consistent with our decisions over the years not to permit any firm to rebate commissions on listed business effectively by doing other business for nothing. Each of the member firms involved receive listed NYSE business on which full nonmember commissions are charged.

The Exchange then advised some of the firms involved in the practice that "* * * we believe that the free clearing of such transactions is contrary to the spirit of our 'commission law' " and that the Exchange "expects" member firms to charge a per-share rate "that will at least cover out-of-pocket expenses for handling such business." The Boston exchange complied with this request, but after discussion with the NYSE, it was agreed that the charge be fixed at 25 cents per item rather than on a per-share basis.

When asked whether his department made any study to determine whether the 25-cent-per-item charge was compensatory, Coyle stated simply, "No, we did not." This 25-cent rate applied to the clearance of each odd-lot order would appear to be far lower than the NYSE clearance charge on agency transactions of 75 cents to $5 per 100 shares, depending on the price of the stock.[556] The resolution of this rebate problem appears to have followed the same pattern as the 50-percent compromise discussed above: a nominal charge converted a prohibited rebate into a permissible arrangement.

(3) *Some consequences of the arrangements*

When the various reciprocal business arrangements and special services have been described, it may be proper to ask whether the inflexibility of the present schedule which gives rise to them constitutes a real problem after all. Do not these arrangements and services informally achieve salutary results? In answering this question, consideration must be given to collateral consequences in terms of difficulties of administration, possible conflicts of interest, distortion of costs, and impact on regional exchanges.

The administrative involvements alone might be considered a sufficient answer to the question.[557] A complex system of arrangements designed to circumvent the strict prohibitions of an antirebate provision would not seem to be a desirable answer to a pricing problem in any industry, even apart from the fact that the Commission is called upon to grant its blessing to such practices, at least tacitly, by approving the commission schedule which begets them.

The possible conflicts of interest arise from the fact that the member's desire to provide reciprocal business to the nonmember professional is likely to exert some influence upon the member to place orders with his reciprocal correspondent in order to fulfill his com-

[556] See table VI-x, p. 298, above.

[557] As early as 1940, a special committee of the NYSE referred to reciprocal business and special service arrangements as a "highly controversial subject":

"No split of commissions with non-members is recommended at this time. But it is recommended that the highly controversial subject of reciprocal business, payment for facilities such as wires, office facilities and the like, all of which have a definite bearing upon commission splits between members, be studied later by a committee appointed as a subcommittee of the Committee on Member Firms."

No record of any such study could be found in the Commission's files.

mitments according to an agreed ratio, rather than transacting all his business in the best available market. Even the member who steadfastly resists this pressure would surely be less vulnerable to criticism or question in the absence of such possible conflicts of interest.

These arrangements also tend to complicate measurements and analysis of the costs of conducting a security commission business.[558] The NYSE Income and Expense Report for member firms provides for deduction from income of security commissions paid to others; yet this is an expense that, in the absence of a reciprocal arrangement, the member might often be able to reduce or eliminate by handling the transaction directly. The report also contemplates deduction of amounts paid for wire services, statistical and advisory services, and similar items, although these expenses cover services that may differ radically in scope from those normally performed for public customers.

A further consequence of these practices concerns the regional exchanges, which are discussed in chapter VIII.E. It has been seen that the regionals have served as an instrument for the transaction of reciprocal commission business. The arrangements have obviously created trading volume for the regionals but has made them dependent to that extent upon the maintenance by the NYSE of a unitary commission structure.

(4) *Possible courses*

A possible solution to these problems would be extension of some form of preferential treatment in the NYSE commission rate structure to nonmember professionals. This would presumably grant such nonmembers the equivalent of present rewards without the existing maze of reciprocal commission and special service arrangements.

As indicated in section 1, the Amex and three of the regional exchanges provide special treatment for the nonmember professional. As of March 1962 the Amex had 415 associates members—there is no limit on the number in this class [559]—compared with 499 regular members. They are subject to exchange discipline (although their partners are not),[560] but they do not vote on matters affecting the exchange and do not share in its liabilities.[561] Since all but 41 of the Amex's associates member firms also have full seats on the NYSE, this class of membership does not appear to have served primarily to provide access for professionals not able to afford a full seat. The Amex has recently amended its constitution to increase the number of its full memberships, apparently with the purpose of encouraging some of its associates to become full members, and at the same time making associate membership more attractive for others.[562]

In 1955, a Special Review Committee on Rules and Procedures of the NYSE investigated the status of the nonmember professional and reached the following conclusions:

[558] The subject of measurement and analysis of cost is more broadly discussed in sec. 4, below.

[559] Amex Constitution, art. IV, sec. 1(c).

[560] The Amex has recently indicated that the subject of disciplinary controls over partners of associate members will be studied with a view to extending such controls to this group. See note 543, p. 299.

[561] Amex Constitution, art. IV, sec. 1(c); art. IV, sec. 4; art. XIII.

[562] As a result of these amendments to art. IV, sec. 1; art. VI, sec. 2; art. VII, sec. 1; and art. II, sec. 2, approximately 60 associate members elected to purchase regular memberships by the end of May 1963. All of these amendments will be wholly effective by the end of July 1963.

Existing provisions for membership in the Exchange are adequate to the needs of the security industry and the Exchange should not create associate memberships.

The committee arrived at these conclusions because it felt that the payment of any reasonable portion of the minimum commission to a nonmember would not represent an adequate inducement for the nonmember to exert effort to produce additional listed business; that any lowering of the standards or basic principles of present Exchange membership would detract from the value of the marketplace. In the opinion of the committee nonmembers who wish to participate in the Exchange business should join the Exchange membership either as partnerships or corporations and contribute directly to the marketplace.[543]

This position was endorsed by the Special Committee on Member Firms Costs and Revenues in 1958. The supplementary report of this committee stated:

The committee found no reason to recommend splitting commissions with nonmembers. Qualified individuals or firms willing to participate in Exchange commission business should join the membership, submit to Exchange regulations and contribute directly to the Exchange marketplace.

Although the first of the quoted reports was made public by the Exchange, it appears that the Commission's review of rate changes on various occasions, as discussed in section 4, did not involve consideration of this aspect of the rate structure. It is clear that the problem warrants further study with active Commission participation. The general objective would be to consider the feasibility and advisability of formulating a special rate or limited membership so that the return received by a nonmember broker-dealer for placing NYSE business would be broadly equivalent to his return under the present system of reciprocal business and special service arrangements. Depending on the details, a probable result of such a change might be a loss in volume of trading on the regional exchanges—an effect requiring candid appreciation and analysis. Thus, one of the questions meriting further study is whether and how the needed flexibility may be introduced into the NYSE commission structure without causing irreparable harm to the regional exchanges.

b. The impact of exchange membership

For the broker-dealer firm which has rendered services relating to a mutual fund, whether in selling its shares or in some other way, the manner in which it will be compensated for such services depends in large measure on the exchange or exchanges of which it is a member.

The problem is least complicated for members of the New York Stock Exchange. As has been suggested above, the fund, fund adviser or fund underwriter which wishes to reward a NYSE member for sales or other services can do so either directly by placing with it an order to buy or sell an NYSE-listed security on the Exchange or indirectly by instructing another NYSE member firm with which it has placed an order to give up a portion of its commission on that order to the firm to be rewarded. In the latter case the rewarded firm performs no function in connection with the execution itself. The give-up of a portion of the commission to it does not violate the Exchange's antirebate rules, which apply only to commission splitting with nonmember firms. From the point of view of the fund and its shareholders, the give-up does not involve an additional amount above the Exchange's minimum commission rate schedule, which requires that it pay the same brokerage commission for a transaction executed on the Exchange, regardless of who performs the execution or benefits from the commission.

The growth in recent years of the over-the-counter market in listed securities [257] casts a shadow of conflict on these transactions, however. If a fund makes a purchase on the NYSE of a listed security which is available as well from an over-the-counter firm on better terms, its choice of the Exchange method would be counter to the best interests of the fund and its shareholders, except in unusual situations.

For a broker-dealer which is not a member of the NYSE but is a member of a major regional exchange, the manner of its reciprocal reward is not substantially more complicated, despite the NYSE antirebate rule. The reciprocal allocation of a portion of portfolio fund brokerage to a wider circle of fund retailers is made possible by the existence of the dual trading system, whereby many NYSE-listed securities are also traded on regional exchanges, and the dual membership system, whereby a number of NYSE members also have memberships on regional exchanges. Thus to reward a broker-dealer firm which is only a member of a regional stock exchange for its sale of mutual fund shares, the fund's investment adviser may instruct a dual member to execute an order for a dually traded security on the regional exchange, and to give up a portion of its commission to the regional-only member firm. Such a give-up is consistent with the

[256] See ch. VI.I.2.b(1).
[257] See ch. VIII.D for a discussion of the over-the-counter market in exchange-listed securities.

rules of the regional exchanges; indeed three regional exchanges [258] permit commission splitting with NASD members which are not exchange members. Although the regional exchanges also have minimum commission rate schedules, which are no higher than those on the NYSE, and their executions are in large measure closely geared to executions on the NYSE, the channeling of reciprocal business through the regional exchanges can also raise questions of conflict of interest. Not only is there always the question whether better terms might be available in the over-the-counter market, but certain practices, such as the "keep in line" order,[259] can sometimes raise a question whether a given execution on the regional exchange in an NYSE stock is as favorable as what might have been obtained on the NYSE. A troublesome aspect of such a conflict of interest is the difficulty in ascertaining whether in each instance the conflict is being properly resolved in favor of the fund's shareholders.

As suggested in chapter VIII.E, reciprocal business is an important aspect of the functioning of regional exchanges. Most of the issues which they trade are also listed on the NYSE. Two-thirds of the four largest regional exchanges' "sole" members (those not members of other exchanges) reported participating in reciprocal business arrangements, and over 60 percent of these participants attributed to such arrangements one-fifth or more of their total exchange income.[260] The major single source of reciprocal business income from institutional investors to the regional exchange firms is probably mutual funds. They were, for example, responsible for $14.9 million of the total of $22.4 million in transactions executed on regional exchanges in April 1962 by the various institutional investors which reported such transactions to the Special Study; when issues listed only on regional exchanges are eliminated from the totals, funds were responsible for $14.5 out of $20.9 million in reported transactions (tables VIII–20 and VIII–20d). On a percentage basis, mutual funds reported transactions on regional exchanges in dually traded stocks in April 1962 which had an aggregate dollar value equal to 9.2 percent of the dollar value of their NYSE transactions in stocks during that period, while no other institutional investor had a percentage higher than 2.6. It would appear that funds and their managers make deliberate use of the regional exchanges in allocating their portfolio brokerage for reciprocal purposes.

For the broker-dealer firm which is not a member of any exchange, the problem of obtaining the benefit of reciprocal business "earned" through selling mutual fund shares or rendering other services is the most difficult. The problems are illustrated in an exchange of correspondence between a nonmember and the investment adviser of a fund whose shares it had sold. The dealer wrote:

> About 2 months ago Mr. [D. H.] was in our office, and at that time we inquired as to the possibility of receiving from you some reciprocal business in consideration of the business which we had done during the past year. * * * Mr. [H.] advised that, normally, whenever a firm had done at least $25,000 business a year they tried to give them some reciprocal business, and he would make it a point to see that we received some.

[258] The Pacific Coast Stock Exchange, the Detroit Stock Exchange, and the Cincinnati Stock Exchange. See ch. VI.I.1.b(2).

[259] See ch. VIII.E.4.d(1).

[260] See ch. VI.I.2.a(1) concerning the extent of sole members' dependence on reciprocal business.

In its reply the investment adviser said:

We would be delighted to place reciprocal business with your firm but since the greater part of our activity is in stocks listed on the New York Stock Exchange it is difficult to get business to a nonmember firm unless they have a correspondent or a member house that they wish to favor. Otherwise we can only wait until there is a new offering which we decide to buy and we can then ask the underwriters to include certain dealers for selling group participation, the stock of course to be taken by us.

* * * * * * *

No one has a preferred position. Sooner or later we will be able to show our appreciation of what you are doing for us. If you have any ideas or suggestions I should be pleased to hear them.

Some months later the dealer renewed its request:

It has been approximately 6 months since we first wrote to you after talking to your Field Representative, Mr. [D. H.].

We appreciate the fact that it is more difficult for you to give us reciprocal business, since we are not New York Stock Exchange members, but we had hoped that by this time there would have been some occasion in which, either through new underwritings or after market offerings, that you might have been able to throw some business our way. Your portfolio shows holdings of various unlisted stocks, so we are still hoping that you may accomplish the above.

The adviser replied:

We have your firm in mind for the first opportunity that develops where we can place your firm in a selling group in a new issue where we could be buying. Also any after-the-market offers where it can be done. We try to work out such an arrangement but quite frequently at the last minute the underwriters are unable to deliver.

I can assure you we very much appreciate your interest in our behalf and are continuing our efforts to find some way of showing this appreciation in a more concrete manner.

These letters suggest some of the problems involved in allocating funds' reciprocal business to over-the-counter dealers and some of the methods which have been used to accomplish that end. The reason reciprocal business is difficult, legitimately, to give to nonmember broker-dealers is the ability of funds and their advisers to deal with the primary market makers in their acquisition and disposition of blocks of stock in the over-the-counter market. There are relatively few wholesale dealers making markets in securities of institutional interest as compared with the number of firms selling mutual fund shares. In the over-the-counter markets commissions and markups are subject to negotiation, and mutual funds dealing directly with primary market makers can often execute transactions at wholesale prices, a benefit not usually available to individual investors. Most funds or their advisers have their own trading or order departments [261] with employees versed in the intricacies of over-the-counter trading who, in the words of one fund, maintain "* * * personal telephone relations with a very large number of brokerage firms * * *" and "* * * have a continual knowledge of the most advantageous markets. * * *" Under these circumstances splitting over-the-counter orders among a number of small over-the-counter dealers is not justifiable because of the higher cost of execution which would generally result. The mutual fund industry has, nevertheless, devised several

[261] All of the 16 load funds and 5 no-load funds to which questionnaire IN–4 was sent reported that they or their investment advisers or managers had established special trading or order departments for supervision of portfolio transactions.

methods by which it can spread the benefits of reciprocity to nonexchange member broker-dealers.

One technique is referred to in the correspondence quoted above. Fund managers sometimes arrange to have nonexchange member dealers included in the selling group of a new underwriting of an issue, some of whose shares the fund intends to purchase, or a secondary offering of an issue which the fund intends to purchase or sell. In this type of reciprocal business the dealer is required to do nothing except receive a check from the managing underwriter for its share of the selling group concession. The managing underwriter handles all details of bookkeeping and the delivery of the shares. The fund, at the same time, incurs no additional expense through the use of a number of dealers acting as members of the selling group, since the price of the shares and the spreads have already been fixed by negotiation between the issuer and the managing underwriter. If a fund participated in such offerings primarily in order to reward nonexchange member dealers, a conflict of interest would be created, but it would be very difficult to determine the existence of any such conflict.

Another device occasionally used to extend the benefits of reciprocity to nonexchange members is known as a "trade-off." Under this arrangement a fund manager directs NYSE-listed business of the fund to an Exchange member firm with a request that the Exchange firm in turn direct over-the-counter transactions to nonmember firms designated by the fund.

Probably the most common method of benefiting nonexchange member dealers, however, is the so-called service give-up. Under this arrangement, the fund manager will direct the NYSE member firm serving as its primary broker to give up a portion of its commission to a second NYSE member firm, which in turn renders services to the nonmember. The services rendered by the member to the nonmember firm are most frequently the sales promotion services discussed in the preceding section, and the pressure to reciprocate nonmember dealers through some method has undoubtedly contributed to the growth of the sales promotional services produced by the five member firms there referred to. The preponderance of the services provided by those firms is in exchange for commissions or commission credits rather than for cash, and the estimate by a partner of one of those firms that his firm provides its services to 40 percent of the mutual fund industry suggest the widespread use of the service give-up. As might be expected, some of the nonmember dealers would prefer to receive the reciprocal business to which they feel entitled in cash rather than merchandise. One such dealer wrote to the Commission:

> A nonmember dealer (not NYSE) works his head off to create millions in brokerage business—and services the funds' clients for years and years in dozens of ways but can't get cash for this extra service. This is wrong!

In their efforts to provide cash compensation to nonmember broker-dealers to reciprocate for the sale of fund shares, some funds and their advisers turn to practices in transactions in over-the-counter securities which resemble the give-up in exchange transactions. The use of the give-up in over-the-counter transactions, however, poses conflicts of interest which do not exist in the present framework of the exchange markets because of the absence of a minimum commission rate structure. In the over-the-counter market a give-up by an executing broker

to another broker inevitably raises the issue of whether the fund involved obtained the best possible price in the transaction. Despite a general awareness by most funds of the obligation to their stockholders to obtain the best possible terms in all transactions, situations came to the attention of the study suggesting that this objective is not always achieved when over-the-counter securities are bought or sold.

An example of an outright over-the-counter give-up occurred in connection with the purchase by one mutual fund in June 1961, of 12,900 shares of Bell & Howell, an NYSE-listed stock, through an over-the-counter firm. The firm, acting as agent for the purchasing fund, acquired the block of shares from a second fund and charged a commission of $5,800 to the first fund at the NYSE rate. Its confirmation noted that it was "a designated sale," and that the firm would participate in the commission only for a total of 6,450 shares and would confirm and deliver. The balance of the commission was shared in by 14 other nonmember firms. While the fund acquired its block of listed stock at the Exchange commission rate, the broker's willingness to give up half of its commission suggests that the fund could have acquired the block for substantially less.

Another method of accomplishing an over-the-counter give-up is by interposing a selected nonmember broker-dealer between the primary broker and the fund. One member of the industry has described the practice as—

> * * * where a fund will go to a primary market and locate stock, and then go to secondary firm and say, "we want such and such a security, and if you go to firm A, which is the primary market, you can get it at a certain figure"; and then have the secondary firm [confirm] at a commission or markup of some sort.

A concrete example of interpositioning in over-the-counter transactions which came to the attention of the NASD in 1959 involved a Boston mutual fund underwriter, one of the funds it underwrote, and a retail specialist in mutual fund shares. In one of the questionable transactions, which involved the sale of an over-the-counter oil stock held by the fund, the fund underwriter instructed the retailer to sell 4,000 shares of the stock and simultaneously gave it the name of an NYSE firm which would purchase the shares. The NYSE firm took delivery of the share certificates directly from a bank designated by the underwriter and sent a check for the proceeds directly to the fund, after deducting a commission for the retailer, who received $800 for his "services."

Although the Special Study found no widespread incidence of give-ups in the over-the-counter market in listed securities,[262] responses to one questionnaire indicated that a few firms had sometimes provided give-ups or interposed other firms when acting as principal or agent in the over-the-counter purchase or sale of NYSE-listed securities. Some of the firms indicated that such transactions were against their present policies, and that they had occurred inadvertently or prior to institution of their policies. One firm apparently viewed the over-the-counter give-up as raising no problems so long as the fund paid no more than it would have paid as an NYSE commission in a transaction executed on the Exchange. The firm stated:

> If our "customer" is an institution who wishes to enable an NASD member to obtain a commission (or a fraction of the regular commission) we are willing

[262] See ch. VIII.D.6.d.

APPENDIX B.

List of Exhibits.

List of Exhibits.

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No. 19922

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

KAMEN & CO., EDWARD F. LIEBERT, ABRAHAM KAMEN, *et al.*,

Appellants/Cross-Appellees,

vs.

PAUL H. ASCHKAR & COMPANY,

Appellee/Cross-Appellant.

APPELLANTS' REPLY BRIEF AND BRIEF ON CROSS APPEAL.

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PAUL H. ASCHKAR & COMPANY,

Appellee/Cross-Appellant.

APPELLANTS' REPLY BRIEF AND BRIEF ON CROSS APPEAL.

I.

Preliminary Statement.

Whether viewed as a "mixed question of fact and law," and thus open for the Appellate Court's decision, or viewed as strictly a question of fact and thus posing the question whether or not the Trial Court's decision was "clearly erroneous," the issues in this case are fundamentally the same.

The District Court found that plaintiff well knew the transactions offered him violated the rules of the New York Stock Exchange. As will be discussed in paragraph II A and C below, this rendered the transactions illegal, and, in itself warrants reversal. The Court also found (and the plaintiff himself testified) that the transaction was unusual, and the agreed facts show that the transaction offered plaintiff a bonus or benefit not required by contract and committed defendant to a

guarantee of the performance of others. The factor of illegality and these other undisputed facts make the finding of ostensible authority and the imposition of liability upon Appellants erroneous.

The basic issues are: given the finding of plaintiff's actual knowledge that the transactions violated Exchange rules, given the additional facts that they were not usual transactions, that they involved a bonus or benefit not required by contract, and a guarantee by appellants of the performance of others, and that appellants did not give any specific indication that the particular transactions were authorized, could ostensible authority for those transactions be inferred from the positions occupied by Ross and Grossinger, and could liability be imposed upon Appellants for their acts in any event, in light of the District Court's findings.

Appellee's Brief relies on two incorrect assumptions, which may somewhat confuse the issues. These are:

(1) that the transactions offered plaintiff by Ross and Grossinger were "reciprocal business" and

(2) that Ross and Grossinger had actual authority to offer such transactions if the stock involved had been legitimate.

These assumptions should be dealt with at the outset, because they can be seriously misleading.

Dealing with the first argument first, the transactions offered plaintiff were not "reciprocal business," despite Appellee's repeated references to them as such.

"Reciprocal business," as the name implies, is the practice of New York Stock Exchange member firms ("member firms") of referring orders from a customer to buy *or* sell an unlisted stock to a non-member firm

who has referred listed stock business to it, thus enabling the non-member firm to find a buyer (or a seller, as the case may be) for the customer, and to earn a commission on the sale.

When the non-member firm takes on such referred commission business (*e.g.*, an order to buy stock) for a customer, it of course undertakes various legal obligations to the customer, such as the duty to exercise due care in promptly locating a seller at the lowest available price, as well as the various other duties that flow from such a fiduciary relationship. Even if the non-member firm should offer to purchase the stock itself, it takes the burden and risk of finding another buyer at a profit.

Plaintiff argues that buyers are available on the regional exchanges, but very often this is not the case, and, particularly with an over-the-counter stock, the search for a buyer or a seller can be very difficult indeed. Even on an exchange, prices fluctuate, and a buyer at the right price may not be available. Plaintiff himself testified that very often the problem of finding a buyer or seller is a difficult and complex matter [Tr. pp. 80-81]. But even in those cases where finding a buyer or a seller may prove less difficult, serious obligations and liabilities have been undertaken by the broker to the client in question. For rendering these services and for fulfilling these obligations, the non-member brokerage firm receives a commission. A referral to a non-member firm of such commission business or of such an order to buy or sell is called "reciprocal business" or sometimes "give-up business." This is the manner in which such business was described at the trial and the manner in which it is referred to in the SEC Report, which was not introduced or offered at the trial, but which Appellee has appended to his Brief.

The transactions offered plaintiff by Ross and Grossinger were not reciprocal business. They were fundamentally and clearly of a different nature. The distinction was plainly made at the trial [Tr. pp. 373, 377, 390-391]. The District Court did not find that referring any form of "reciprocal business" violated the Stock Exchange rules, as appellee suggests (App. Br. p. 8), but found only that the fixed-profit rebate transactions given to plaintiff (a wholly different thing) violated those rules, and that this fact was well known to plaintiff at the time he entered into these transactions.

Ross did not refer to plaintiff a customer who wanted to buy (or sell) an unlisted stock, so that plaintiff might, acting for that customer, find a seller (or buyer) and thus earn a commission. Ross gave plaintiff the name of a seller at one price and, at the same time, the name of a buyer at a higher price, and guaranteed both ends of the transaction, thus creating a fixed, guaranteed and wholly unearned profit, which plaintiff merely had to collect. Plaintiff did not have to find a buyer or a seller, or take any risk at all, or undertake at any time to act for anyone else or assume any obligations or liabilities, which flow from such an undertaking. All he had to do was act for himself in collecting the prearranged profit and thus realize his rebate. As plaintiff testified, Ross simply gave him the profit in exchange for his listed business [Tr. 140].

The giving of such an arranged profit is no different from plaintiff's receiving cash or a car in exchange for

giving his listed business to defendant. It is plainly a rebate and cannot be likened to the referring of commissioned business, commonly called "reciprocal business". Plaintiff himself was aware of the distinction when he accepted the arranged profit transactions. He knew and testified that such transactions were not "usual" [Tr. pp. 97-98]. He certainly knew of no broker penalized for referring "reciprocal business", yet he testified that, at the time he accepted the transactions in issue, he specifically knew of one suspended for becoming involved in the type of transaction offered by Ross and Grossinger [Tr. pp. 98-100].

Even in Appellee's Brief it is conceded that "Of course a transaction arranged solely for the purpose of giving a profit to an over-the-counter broker-dealer violates the rebate rule." (App. Br. pp. 28-29). Yet, the referral of "reciprocal business" is not such a violation, according to the SEC Report appended to Appellee's Brief.

Nevertheless, over and over again, Appellee's Brief refers to these arranged profit transactions as "reciprocal business." There is nothing in the SEC Report or in evidence that supports this designation in any way, and it is important to a correct analysis of the case that this semantic error be avoided. Otherwise, it is easy to succumb to the erroneous logic of Appellee's position: that the transactions here were "reciprocal business," that the referral of reciprocal business is common, and, *ergo*, that the transaction here was a common one.

The transaction here was not reciprocal business and was not usual. Moreover, it was a plain violation of the Exchange rules and found to be such by the Court. Defendant well knew this, as the Court also specifically found.

The fallacy in calling these transactions "reciprocal business" carries over into Appellee's second assumption which is equally incorrect. Thus, Appellee reasons that Ross and Grossinger must have had actual authority to refer legitimate "reciprocal business" to non-member firms, and, therefore, that plaintiff cannot avoid liability because (unknown to plaintiff) the stock involved here was not "legitimate" (see Appellee's Br. pp. 21, 29). But this argument leaves out a logical step which plaintiff cannot take—that the transactions in issue are "reciprocal business" and therefore would be authorized if the offered stock were legitimate. It also wholly misconceives our position. The basis of our contention that the transactions were unauthorized is not that the Jerome Richards stock was fraudulent. Our position is that the arranged-profit transactions, *even in legitimate stock,* were unauthorized, because they violated the New York Stock Exchange rules. If Ross gave plaintiff such an arranged profit transaction in General Motors stock, it would be just as much a violation of the Exchange rules, and equally unauthorized.

This is not a situation where an agent has authority to offer a particular transaction if the stock is valid, and thus, the principal cannot escape liability if the agent offers that transaction with invalid stock. Here the arranged-profit transaction itself is beyond the scope of the agent's actual authority, whether or not the stock

used to create the artificial profit is valid or fraudulent. The lack of authority does not come from the fact that the stock of Jerome Richards was valueless and fraudulent, but from the fact that the type of fixed-profit transaction violated the Stock Exchange rules, even if the stock had been legitimate and with a value as impliedly represented.

Here again, the flaw in plaintiff's logic comes from calling the transactions "reciprocal business," which plainly they are not, and reasoning from that label that, accordingly, they must have been actually authorized if the stock to be traded was legitimate.

Once these two incorrect assumptions are eliminated, the fundamental issues can squarely be faced. Where an agent has no actual authority to offer a transaction, the principal neither knows nor has reason to know of the offer, and the plaintiff (a professional broker of long experience) knows the transaction violates the rules of the Stock Exchange of which the principal is a member, knows that the transaction is an unusual one and that it involves a bonus or benefit to him not required by contract and a guarantee by the principal of the performance of others, can ostensible authority of the agent to make the offer, and to make representations in connection with the offer, be inferred from the agent's position and, in any event, can liability for those misrepresentations be imposed upon the innocent principal.

Under the rules of law set out below, whether this issue is analyzed as a question of fact or of law, or of mixed fact and law, the answer is no.

II.

Whether or Not the Finding of Ostensible Authority Is Within Rule 52(a), the Judgment Should Be Reversed.

In our Opening Brief, we tried to show that an issue such as the existence of apparent authority could be a question of fact for one purpose and under one set of circumstances, and yet be primarily a conclusion of law for another purpose or in other circumstances, and that it was not accurate or helpful to label a particular issue one of "fact" or "law" for all purposes and without regard to the circumstances or how or in what court the issue arose.

Thus, we cited cases showing that a particular issue could be considered a question of fact for state court purposes and yet be deemed one of law for purposes of federal appellate review (App. Op. Br. pp. 11-12) and that, even in the same jurisdiction, a particular issue could sometimes be treated as one of fact and sometimes one of law (App. Op. Br. p. 13).

We cited cases indicating that the fundamental test is whether the issue in the particular case is one dealing essentially with "the effect of certain transactions or events" rather than the "resolution of disputed facts." (App. Op. Br. pp. 10-14).

Appellee has cited other cases, describing the test as turning on whether resolution of the particular issue requires "experience with the mainsprings of human conduct" (App. Br. pp. 15-16).

Appellee has also cited cases, both in the State Courts and in the Fifth Circuit, labeling the question of ostensible authority one of "fact." However, analysis of these

decisions reveals that the trial court could not determine the issue of ostensible authority without resolving conflicts in the evidence, and that reversal on appeal would involve the appellate court in these disputed factual areas.

Our case is quite different. Even plaintiff agrees that most of the facts relating to the issue of ostensible authority are undisputed. But, even beyond that, the basic facts which call for a reversal of the judgment were actually found by the District Court. Thus, the trial judge found that plaintiff well knew the transactions he was offered violated the rules of the New York Stock Exchange and that the transaction was an unusual one. These facts found by the District Court, standing alone, call for a reversal of the judgment as do other undisputed facts in the record to which we will refer below.

The question of ostensible authority in this case did not involve the resolution of disputed facts, but called for a determination of the legal effect of those facts that were agreed upon and found by the Trial Court. Having in mind those facts, the Court had to apply a legal standard to decide if there was "ostensible authority." In making that determination, the Court applied an erroneous standard. Thus, the findings demonstrate that the District Court felt:

(1) that the fact that plaintiff knew the transactions violated the Stock Exchange rules did not render them illegal *as to plaintiff,*

and

(2) that if the transactions were not illegal *as to plaintiff,* they would not prevent ostensible authority.

The application of such standards does not involve experience with the "mainsprings of human conduct." It would be different if the Court had found that plaintiff believed the transactions in issue did *not* violate the Exchange rules and that plaintiff was reasonable in that belief. Such findings would involve an evaluation of the witnesses' testimony and would certainly require "experience with the mainsprings of human conduct," but this was not the case. The Trial Court found that plaintiff *did* know that the tansactions violated the rules, and the issue now is as to the legal effect of that determination and as to whether the Court was applying incorrect legal standards.

This being so, the conclusion of ostensible authority in our case should not be considered within the "clearly erroneous" rule of Federal Rule 52(a).

However, even if the case were deemed one within that rule, it would be one which calls for reversal, in that, taking the facts as found by the District Court the finding on the question of ostensible authority was clearly erroneous and, in any event, the imposition of liability upon appellants for the acts of their agents was incorrect as a matter of law.

A. On the Facts as Found by the Trial Court, There Could Be No Proper Inference of Ostensible Authority.

It is a fundamental rule of agency law that one who deals with a person he knows to be an agent has the duty to ascertain the scope of the agent's authority, and must bear the risk that the transaction is unauthorized if he does not fulfill that duty of inquiry.

Ernst v. Searle, 218 Cal. 233, 240 (1933);

Torrance N. Bank v. Evesco F. Credit Union, 134 Cal. App. 2d 316, 324 (1955);

LaMalfa v. Piombo Bros., 70 Cal. App. 2d 840, 844 (1945).

Thus, *in Ernst v. Searle, supra,* the California Supreme Court stated:

> "A third person, such as appellant, is not compelled to deal with an agent, but if he does so, he must take the risk. He takes the risk not only of ascertaining whether the person with whom he is dealing is the agent, but also of ascertaining the scope of his powers. The rule is cogently stated in 1 Mechem on Agency, second edition, section 743, page 527, as follows: 'An assumption of authority to act as agent for another of itself challenges inquiry. Like a railroad crossing, it should be in itself a sign of danger and suggest the duty to 'stop, look and listen.' It is therefore declared to be a fundamental rule, never to be lost sight of and not easily to be over-estimated, that persons dealing with an assumed agent, whether the assumed agency be a general or special one, are bound at their peril, if they would hold the principal, to ascertain not only the fact of the agency but the nature and extent of the authority, and in case either is controverted, the burden of proof is upon them to establish it.' " 218 Cal. 233, 240 (1933).

The doctrine of apparent authority is not inconsistent with this rule. If the principal indicates to the third party that the agent is authorized to enter into a particular transaction, the third party has fulfilled his duty to inquire, and the principal will be liable, even if he

has secretly instructed the agent not to enter into such a transaction.

Where there is a specific indication from the principal to the third party that the agent is authorized to engage in a particular act, there is no problem in finding ostensible authority, and, thus, finding that the third party has satisfied his duty of inquiry. Where the difficulty arises is in situations like the instant case, where the principal does not indicate that the *particular* transaction is authorized, and the argument for his liability is based upon the assertion that he has placed the agent in a position from which apparent authority to enter into the particular transaction could be inferred.

This is the situation in our case. There is no evidence that Mr. Kamen specifically indicated to the plaintiff in any way that Ross and Grossinger were authorized to enter into the particular transactions in issue. The contention that there is apparent authority is founded essentially upon the fact that he permitted Ross to issue a card saying he was manager of Kamen's broker-dealer department and thus created the impression in plaintiff that Ross could do the things such a manager could do.

In such situations, the authority or apparent authority to enter into the particular transaction must be inferred from the general position of the agent. The scope of the agent's apparent authority is determined in the same way as that of his actual authority, excpt that it is measured from the point of view of the third party, rather than from the point of view of the agent.

Restatement of Agency 2d, Section 49.

Thus the question becomes, in light of the third party's knowledge (or the facts he had reason to know),

could authority for the particular transaction be reasonably inferred from the agent's position.

In deciding what sort of authority or apparent authority can be inferred from the general position of an agent, the Courts have formulated fundamental rules, several of which are applicable in this case.

The basic rule is that the third party may properly infer that the agent has authority to do everything *usual* and proper to fulfill his position.

California Civil Code, Section 2319;

Restatement of Agency 2d, Section 73, comment (b).

Under this rule, if the transaction is an unusual one, apparent authority or actual authority will not be inferred from the general position of the agent, even if he is a manager.

(Restatement of Agency 2d, Section 73, Comment (b)).

As the Restatement puts it, "any substantial departure from the usual methods of conducting business is ordinarily a sufficient warning of lack of authorization."

Restatement of Agency 2d, Section 166, Comment.

Of course, liability for an unusual transaction may be created by a specific grant of authority or a specific statement by the principal that the particular act is authorized, despite the fact that it is unusual, but there is no such evidence in the record in our case.

As to whether the transactions in issue were "usual", the plaintiff admitted and the District Court specifically

found that they were "unusual" [Tr. pp. 97-98; Find. 35], and there is no question but that this was plain from the balance of the record [*e.g.,* Tr. pp. 135, 374, 390-391].

But there are even more specific rules which prevent an inference of ostensible authority in our case.

The most significant of these rules to our case is that, in the absence of extraordinary facts, such as a specific statement by the principal that the agent is authorized to enter into the particular transaction, authority or apparent authority to enter into an illegal transaction will not be inferred.

Restatement of Agency 2d, Section 34(d), Comment (g);

Call v. Palmer, 116 U.S. 98, 102, 29 L. Ed. 559, 561 (1885);

Shotkin v. Mutual Benefit Ass'n, 138 F. 2d 531, 533 (2d Cir. 1943);

California C. P. Growers v. Harris, 91 Cal. App. 654, 659 (1928);

Eckstein v. Eckstein, 49 N.Y.S. 2d 726* (1944);

Smith v. Southwestern Bell Tel. Co., 349 P. 2d 646 (Okla. 1960);

Rogers v. First State Bk. of Aguilar, 79 Colo. 84, 243 Pac. 637, 639 (1926);

See

California Highway Commission v. Reily, 192 Cal. 97, 107 (1923);

Nuffer v. Ins. Co. of No. America, 236 A.C.A. 372 (1965).

*The *Eckstein* case is miscited at p. 29 of our Opening Brief.

This is not to say there cannot be a case in which the principal gives actual authority for an illegal transaction or in which the principal specifically indicates to a third party that his agent is authorized to enter into such a transaction, even if he has secretly instructed the agent not to do so. The rule above cited extends only to the question (fundamental to our case) of whether authority to enter into an illegal transaction can be inferred from the general position of the agent, and the courts have uniformly held that it cannot.

In our case, the District Court has specifically found that the plaintiff well knew that the fixed-profit transactions offered him by Ross and Grossinger were in violation of the rules of the New York Stock Exchange, of which defendant was a member [Find. 35].

Appellee argues that the rules of the Stock Exchange are not "law" and therefore the transactions were not "illegal." The District Court apparently acted under the same misimpression in making its findings that, despite the fact plaintiff knew the transactions offered violated the Stock Exchange Rules, they were not "illegal insofar as the plaintiff's participation therein was concerned" [Find. 35].

However, both of these positions misconceive the law. Admittedly the Stock Exchange Rules are not statutes (although they are authorized by statute and controlled by a statutory commission) and their violation is not a crime (although it does lead to severe administrative penalties). But this does not mean that an agreement known to be in violation of the rules is not illegal. In fact, it is one of the classic examples of illegality.

Restatement of Contracts, Section 576, illustration 3.

Rules of the Stock Exchange not only provide regulation of Exchange procedures and the activities of the Exchange members, essential to the public interest,* but constitute a contract between the members of the Exchange.

E.g.,

Roberts v. Criss, 266 Fed. 296, 300-301 (2d Cir. 1920).

Contrary to the rule applied by the District Court, an agreement which calls for one of the parties to breach his contract with a third party is an illegal agreement.

Restatement of Contracts, Section 576.

E.g.,

Roberts v. Criss, supra, at pages 301, 302;

Reiner v. No. American Newspaper Alliance, 259 N.Y. 250, 252 (1932).

*The Exchange Rules are sanctioned by the Securities and Exchange Act of 1934, and are vital to carrying out the aims of self-regulation intended by Congress in enacting that legislation. See:

Silver v. New York Stock Exchange, 373 U.S. 341, 352-356, 10 L. Ed. 2d 389, 397-399, 83 S. Ct. 1246 (1963).

The answer to plaintiff's suggestion that the commission fixing rules may be a violation of the anti-trust laws, is that the 1934 Act expressly sanctions Exchange Rules fixing commission rates and gives the SEC the power to review and alter such rules. 15 USC Section 78s(b); See *Pan American Airways v. United States,* 371 US 296, 298, 9 L. Ed. 2d 325, 328, 83 S. Ct. 476 (1963). The *Silver* case, *supra,* which plaintiff cites for the proposition that the commission rule may be invalid, fails to support that proposition at all. In that case, the Supreme Court held that the particular method of enforcement of another exchange rule exceeded the authority of the Exchange under the 1934 Act and, therefore, was subject to the anti-trust laws. 373 US 341, 364-365, 10 L. Ed. 2d 389, 404.

Thus, Section 576 of the Restatement provides:

"A bargain, the making or performance of which involves breach of a contract with a third person, is illegal.

Comment:

a. Since breach of contract is a legal wrong, a bargain that requires for its performance breach of a contract with another, is opposed to public policy."

Strikingly enough, one of the Restatement's specific illustrations of this type of illegality is an agreement under which one of the parties will be called upon to violate a stock exchange rule (in fact the rule violated in our case). Thus, the illustrations to Section 576 include the following example of illegality:

"Illustrations: . . .

3. A. bargains with B., a member of a stock exchange, to give B. stock brokerage business in consideration of B.'s charging reduced commissions in violation of the rules of the Stock Exchange, by which B. had agreed to be bound when he became a member. *The agreement is illegal.*" (Emphasis added).

Restatement of Contracts, Section 576, illustration 3.

A specific decision to this effect, and one of the leading cases in the field, is *Roberts v. Criss,* cited above, 266 Fed. 296, 300-302 (1920). In that case the contract in issue was one which would have caused one of the parties to violate the Stock Exchange Rules. The

court held the contract illegal, analyzing the nature of the rules and the contractual rights of the other exchange members which require that such agreements be unenforceable.

A similar case, and one which specifically deals with the authority of an agent to enter into such a transaction, is *California C. P. Growers v. Harris,* 91 Cal. App. 654, 659 (1928). That case dealt not with the violation of a stock exchange agreement but with the analogous situation of a cooperative marketing agreement among fruit growers, under which the growers agreed with a growers association that each would sell its peach crop to the Association. The Association sued the defendant for selling his crop elsewhere, and the defendant's argument was that a general agent of the association advised him that the Association would not buy his peaches. The Trial Court, apparently believing that there had been such a conversation, held for the defendant. The judgment was reversed on appeal on the theory that any arrangement between the agent and the grower under which the grower would sell his crop elsewhere, would constitute a breach of the cooperative marketing agreement and violate the rights of the other growers and, accordingly, that the Court could not infer that the agent had authority to so act.

Since, in our case, the Court found that plaintiff well knew the transactions offered by Ross and Grossinger violated the Stock Exchange rules and since, under the authorities cited above, this rendered those transactions illegal, authority on the part of Ross and Grossinger to enter into such transactions cannot be inferred from their positions as general agents, but could only be based

upon a specific authorization from plaintiff or a specific statement from defendant to plaintiff that this particular type of transaction was authorized.* Of course there was no specific grant of authority, nor was there any such specific indication from defendant that this particular type of transaction was authorized.

Accordingly, taking the facts as found by the District Court, the inference of ostensible authority was based upon the application of an erroneous legal standard, could not properly be drawn and should be reversed.

Even beyond the rule that ostensible authority will be inferred from an agent's position only where the transaction is usual and proper, and the rule that it will not be inferred from the agent's position if the transaction is illegal, there are other such rules which render the inference of ostensible authority improper in this case. For example, authority to render a bonus or benefit to a third party not required by law or contract will not be inferred from the general position of the agent, even if the bonus might indirectly bring benefit to the principal.

1 Mechem, *Agency,* page 707.

E.g.,

Harbor Const. Co. v. Walters, 101 Cal. App. 470, 474 (1929) [Manager has no authority to waive contract rights];

Union Pacific Town-site Co. v. Page, 54 Kans. 363, 367 (1894) [Development company's

*Even if the transactions in issue were not described as "illegal," but only in violation of the Exchange Rules, the result should be the same. Surely, a third party dealing with an agent cannot reasonably infer from his general position that the agent has authority to enter into a transaction which the third party knows will place the principal in breach of contract and subject him to severe administrative penalties.

agent has no authority to pay for lumber for lot buyer];

Brenard Mfg. Co. v. Sketchley Store, 185 Iowa 694, 699 (1919) [Store manager has no authority to acquire jewelry to give away to customers];

Flowers v. Bush and Witherspoon Co., 254 Fed. 519, 521, 522 (5th Cir. 1918) [General agent has no authority to cancel contract gratuitously].

See

Howard v. Winton Co., 199 Cal. 374, 379 (1926).

In our case, plaintiff was plainly receiving a bonus or benefit not required by law or contract, when he was offered the pre-arranged-profit transactions by Ross and Grossinger. Under the cases, even without the factor of illegality, the authority of the agent to give plaintiff such an unrequired benefit could not be inferred from his position as manager of the broker-dealer department, and, again, there is not a scintilla of evidence that defendant Kamen specifically indicated in any way to plaintiff that this particular type of arranged-benefit transaction was authorized.

A fourth rule which also renders the inference of ostensible authority improper is that authority to issue a guaranty or to make the principal liable for the performance of a third party will not be inferred from the general position of an agent unless the transaction is indispensable to the performance of his duties.

1 Mechem, *Agency,* pages 712-713, 724.

E.g.,

Zellerbach Paper Co. v. Virden Pkg. Co., 10 Cal. App. 2d 635, 640 (1935);

First Nat'l Bank v. Farson, 226 N.Y. 218, 224, 123 N.E. 90 (1919);

In re Union City Milk Co., 329 Mich. 506, 310 (1951);

Restatement of Agency 2d, Section 73, Comment (b) illustration 7.

In our case, seller's performance, the buyer's performance and, thus, the entire arranged profit, was guaranteed by the principal, Kamen & Co., bringing the case squarely within this rule and again rendering the inference of ostensible authority improper.

We have cited four rules of law which call for a reversal of the inference of ostensible authority, in light of the fact that defendant never indicated that the fixed profit transactions were specifically authorized: (1) the rule that such authority will not be inferred unless the transaction is a usual one; (2) the rule that such authority will not be inferred if the transaction is illegal; (3) the rule that such authority will not be inferred if the transaction confers a bonus or benefit not required by contract; and (4) the rule that such authority to make the principal responsible for the performance of a third party will not be inferred unless indispensable to proper performance of the agent's duties. Each of these rules would call for a reversal of the conclusion of ostensible authority.

In our case all four rules apply. The transaction was admitted by plaintiff and found by the Court to be an unusual one, although the Court, apparently placing

upon the plaintiff a far lighter burden than required by the authorities, added in its findings that it was not "so unusual or shocking" as to put the plaintiff on notice. Aside from its being unusual, the transaction was an illegal one. In addition, it plainly conferred upon plaintiff a bonus or benefit not required by law or contract and bound defendant to a guarantee of the performance of others.

Accordingly, under the authorities we have discussed, whether the inference of ostensible authority is deemed a finding of fact or a conclusion of law, it should be reversed.

Appellee cites Restatement Section 231 to the effect that the principal may be liable even for illegal or tortious acts of the agent (App. Br. p. 37). Of course this is so, but not where the plaintiff has reason to know the transaction is illegal or tortious and where there is no indication of specific authority from the principal for the particular transaction.

Plaintiff argues "the fact that Appellee did not have a previous similar transaction is totally irrelevant" (App. Br. p. 29, n. 9). But this does not accord with the law of California. Not only does this fact support the finding that the transaction was "unusual," but in this state, the cases have held that where a third party seeks to rely upon the ostensible authority of an agent, he must produce evidence that at least one similar transaction on the part of the agent has been actually authorized or ratified by the principal.

E.g.,

Credit Bureau of San Diego v. Beach, 144 Cal. App. 2d 439, 444 (1956).

See

2 Cal. Jur. 2d 700.

In response to the argument that plaintiff could have prevented the loss by a simple inquiry into the scope of Ross and Grossinger's authority, plaintiff argues that he did check with the "owner", in that Ross was the manager of the broker-dealer department and represented the owner (App. Br. p. 21, n. 6). But this reasoning is patently circular. Plaintiff knew that, regardless of his title as manager of the broker-dealer department, Ross was a mere agent, and he could not fulfill a duty to ascertain the scope of the agent's authority by talking to the agent himself. It would have been a simple matter to check with Mr. Kamen, in which event he would have been advised that such transactions were wholly unauthorized and the entire loss would have been prevented.

Plaintiff points out that defendant Kamen & Co. has received and retained gross commissions of $166. on the listed business referred to it by plaintiff. But it should be noted that, as was found by the District Court, these were commissions on the handling by Kamen & Co. of sales of legitimate listed securities for plaintiff's customers and did not in any way involve the trading of Jerome Richards stock [Find. 20]. There is no evidence of any demand or request by any of these customers for rescission or cancellation of these legitimate, listed-stock sales or for return of the commissions paid by them to Kamen & Co. As the District Court also found, Kamen & Co. was at no time involved in trading of the stock of Jerome Richards & Co. and it earned no commissions whatsoever on such Jerome Richards trading. In light of these facts, the fact that plaintiff earned and retained commissions on the legitimate listed stocks traded by customers referred by plaintiff has no legal significance. If Kamen & Co. had earned commissions

on plaintiff's Jerome Richards transactions and, despite a demand for return of those commissions by plaintiff, retained those benefits, it is possible that plaintiff could mount an argument that this conduct amounted to a ratification of the fraud. But the facts in our case warrant no such argument.

Plaintiff argues that the SEC Report appended to his Brief discusses forms of reciprocal business referred by New York Stock Exchange member firms to non-member firms which involve "fixed profits." But, an examination of the SEC Report reveals that it is dealing with the practice of referring commission business to non-member firms; and, even if the commissions earned are, in a sense, "fixed," the referring of such business is nothing like the granting of a guaranteed-profit arrangement in order to direct a cash rebate into plaintiff's hand. The distinctions are manifest and are discussed in paragraph I. above.

Even the compensation techniques which the SEC Report relates are employed by mutual funds, and which, since they are not rebates by New York Stock Exchange members, do not apply here in any event, do not extend to such blatant rebating as occurred here.

Plaintiff contends that when he filled out the forms to receive his guaranteed profit he rendered "execution and clearance services" which he presumably contends take his case out of the category of a rebate (App. Br. p. 3). But the execution and clearance services rendered by a stock broker in earning a commission, which involve the responsibility of acting for the customer, with its corresponding obligations and liabilities, cannot reasonably be compared to the ministerial paperwork done by plaintiff for his own account to collect his arranged

profit. There is nothing in the SEC Report at the page cited by plaintiff (App. Br. p. 3) or anywhere else, that indicates that what plaintiff did in this case could be construed as rendering "execution and clearance services." Plaintiff might just as well argue, if he had been given a rebate in the form of a cashier's check, that by endorsing the check, making out a deposit slip and mailing these documents to his bank he rendered "execution and clearing services" and thus took his cash payment out of the category of a rebate.

Appellee argues that when Kamen & Co. acts for its own customers, it does no more than plaintiff did to collect his arranged profit given by Ross and Grossinger. This is the same argument again. Kamen & Co., like any other broker, acting for a customer to earn a commission, renders services and undertakes serious liabilities to earn its fee. Frequently, even before there is a purchase or sale, such a broker is called upon to analyze the securities in question, or many other securities, and to give advice, counseling and recommendations to the potential customer. If those recommendations are negligently given, or the analysis negligently made, there is serious liability. Once there is to be a sale, if the customer is a seller, the broker must promptly record the order and have his man on the Exchange floor locate a buyer (or vice versa) and must see that the sale is promptly consummated. If the broker is not prompt in carrying out the order, he may be liable to the customer for substantial damages. The broker may receive an order to sell or to buy at a specific price, in which event he must be alert to any moment at which that price is reached, or, again, he may be liable. The broker may retain a clearing firm, instead of employees for certain of its

services, or it may use both a clearing firm and its own men on the floor of the Exchange, as Kamen & Co. did [Tr. pp. 257, 276], but its liability is the same. The clearing firm fulfills only a few of the foregoing functions [Tr. p. 257]. The basic responsibility is still that of the fiduciary broker.

Such a situation cannot reasonably be compared with plaintiff being given the name of a buyer at $19.00 per share and the name of a seller at $19.50 per share and told that all he has to do is pocket the difference, with both ends guaranteed by Kamen & Co. Such a transaction is obviously just a poorly disguised cash bonus, and the statement that its receipt is no different from Kamen & Co.'s normal activities in serving its customers for a commission just does not stand up to analysis.

No matter how much plaintiff may protest that what he took from Ross and Grossinger was just the same as an ordinary referred-commission business, and no matter how frequently he may label these rebate transactions as "reciprocal business," the facts will not support such conclusions. In any event, the Trial Court in its findings did not accept plaintiff's position in this regard. It plainly and unequivocally found that plaintiff well knew that the transactions he received violated the New York Stock Exchange rules. This being so, and there having been no evidence of any specific indication from defendant to plaintiff that the particular transactions were authorized, there can be no ostensible authority.

Plaintiff relies in his Brief upon ostensible authority cases which we have previously cited and distinguished. It is plain, and we concede, that slight or technical dif-

ferences from normal procedures will not necessarily remove a transaction from the scope of an agent's apparent authority—particularly where the third party dealing with the agent is a layman and one of limited knowledge. Thus, the minor procedural differences from the norm in *Walsh v. Hooker & Faye,* 212 Cal. App. 2d 450, 454 (1963) (App. Br. p. 34) and *Blackburn v. Witter,* 201 Cal. App. 2d 518, 521 (1962) (App. Br. pp. 34-35) [which cases are discussed and distinguished in our Opening Brief at pages 24 through 26], can hardly be compared with the flagrant rebate scheme offered in our case to a professional dealer of long experience and known by him to be in violation of the Exchange rules and to involve an unrequired bonus or benefit and a guarantee by the principal . . . all factors which do not appear in the cases cited by plaintiff.

Similarly, in *Ghiglioni v. American Trust Co.,* 49 Cal. App. 2d 633, 637 (App. Br. p. 35) there was no indication that the plaintiff (an elderly immigrant who could barely read English) had reason to know that the transactions offered him were unusual or improper.

No case cited by plaintiff permits an inference of apparent authority for a transaction known to the plaintiff to be illegal (or, if plaintiff prefers, known to put the principal in breach of a contract with a third party and likely to subject him to severe penalties), or for a transaction giving plaintiff the principal's guarantee of the performance of another party where that is not indispensable to the agent's function, or for a transaction which involves a bonus or benefit not required by law or contract; and certainly no case finds apparent authority where all such factors coincide.

Accordingly, whether deemed a finding of fact or a conclusion of law, the Court's inference of ostensible authority cannot be a correct one, in light of its findings of fact, and that conclusion, and the judgment based thereupon, should be reversed.

B. Appellants Are Not Liable Under Other Agency Doctrines.

Appellee's Brief refers to other agency doctrines which he contends support liability even if there is no ostensible authority and despite any reason on plaintiff's part to doubt the authority of Ross and Grossinger.

Thus plaintiff argues that *whether or not he had reason to doubt the agents' authority,* appellants are liable if (1) Ross and Grossinger were "servants" and the transaction was within the "scope of their employment," or (2) if it was within their "agency powers" or (3) within the scope of appellants' "non-delegable duties."

But no such terminology alters the basic issues in the case or frees plaintiffs from the rule (basically restating the test of ostensible authority) that the plaintiff may not recover if, in light of the facts known to him, or which he should have known, he could not reasonably infer authoriy for the particular transaction. As analyzed in paragraph A. above, on the facts found by the Trial Court, plaintiff could not properly draw such an inference.

1. *Scope of servants' employment.* In the instance of non-transactional torts, such an assault or negligent physical injury, which are not based upon dealings between the agent and the plaintiff and where the plaintiff's state of mind as to the authority of the agent is irrelevant, liability is founded upon the fact that the

agent was a "servant" and was acting within the "scope of his employment" (Restatement of Agency [2d], Section 219).

But these standards have no application to the determination of authority to make misrepresentations in dealings with the plaintiff, a situation in which the plaintiff's state of mind is of the essence. Thus, the Restatement has set up special rules for determining authority in fraud cases, which make it clear that, in such cases, no distinction is made between "servants" or other agents, that the "scope of employment" is not a significant test and that, in any event, there can be no liability where the third party could not reasonably believe the agent was authorized.

Thus, Section 249 of the Restatement, in dealing with liability for misrepresentations, discards the distinctions applied in dealings with non-transactional torts, and provides:

> "A master is subject to liability for the misrepresentations of a servant causing pecuniary loss as he is for the misrepresentations of an agent who is not a servant.
>
> Comment:
>
> a. A detailed statement of the liability of a master or other principal for the misrepresentations of agents which causes pecuniary harm is made in Sections 256-265. It is to be noted that in such situations the master or other principal may be liable for the acts of a servant or an apparent servant who acts wholly for his own purposes and hence is not acting in the scope of employment."

Referring then to the particular sections which deal with the liability of a principal for the misrepresenta-

tions of his agent (whether the agent is a servant or not, and whether or not the representations are within the scope of his employment) it is apparent that, in no event, can there be liability for such misrepresentations where the third party had reason to doubt the authority of the agent, or, put differently, where he could not reasonably infer that the agent was authorized to enter into the particular transaction. This is repeated at several places throughout the Restatement sections dealing with liability of the principal for fraud. Perhaps it is most clearly stated in Comment c. to Section 258, which provides as follows:

> "Comment"
>
> c. WHERE THIRD PERSON SHOULD KNOW THAT THE AGENT IS UNAUTHORIZED. *A principal is not liable in deceit for unauthorized representations made to a person who has reason to believe that they are not of the sort authorized.* If, therefore, the representations are of a sort which, in view of the nature of the agency, the article sold, and the purpose for which it is sold, normally would not be authorized, the other party has no action of deceit against the principal who did not authorize them. Likewise, if the representations are as to a matter concerning which the other party, in view of business customs and other facts which he knows or should know, should realize the agent is not authorized to make statements, the principal is not liable for them." (Emphasis added.)

This section would seem, in itself, to demonstrate that Appellee's position is incorrect.

To the same effect is Restatement Section 261, the language of which has been adopted in California in *Walsh v. Hooker and Faye,* 212 Cal. App. 2d 450, 454 (1963), at page 456, stating that in fraud cases, it is necessary to liability that: "from the point of view of the third person, the transaction seems regular on its face and the agent appears to be acting in the ordinary course of business confided to him." The same language is approved in *Rutherford v. Rideout Bank,* 11 Cal. 2d 479 (1938).

At pages 33 to 35 of his Brief, Appellee cites and discusses several cases which he evidently contends stand for the proposition that if the agent commits a fraud within the scope of his employment, the principal may be held liable even though the third person dealing with the agent had reason to doubt the agent's authority. But not one of these cases stands for that proposition. Included among the cases are *Blackburn v. Witter,* 201 Cal. App. 2d 518; *Walsh v. Hooker and Faye,* 212 Cal. App. 2d 450 and *Ghiglioni v. American Trust Company,* 49 Cal. App. 2d 633, already discussed at pages 24 through 26 of our Opening Brief and at page 27 of this Brief. These cases, as well as *Rutherford v. Rideout Bank,* 11 Cal. 2d 479, *J. C. Millet & Co. v. Park and Tilford Distillers Corp.,* 123 F. Supp. 485 and the majority of the other cases cited in this section by plaintiff, expressly turn on the *ostensible authority* of the agent and, thus that the third person dealing with the agent had no reason to doubt his authority. It is true that two of the cases cited by defendant, *Mitchell v. Union Pacific Railroad Co.,* 188 F. Supp. 869, 873 (S.D. Cal. 1960) and *Ralston Purina Co. v. Novac,* 111 F. 2d 631, 636 (8th Cir.

1940) use the term scope of "employment" rather than scope of "authority" or "ostensible authority" in discussing the reasons for the principal's liability. However, in those cases the transactions in question were plainly within the scope of the agent's ostensible authority, and there is not the slightest suggestion in either case, or in any of the authorities cited by plaintiff, that there would be liability if the third party dealing with the agent had reason to doubt his authority.

We have been able to find no case or other authority supporting that extreme contention. It is flatly contrary to the rules set out in the Restatement of Agency and clearly expressed in the California cases. Such a doctrine would be a harsh one indeed. It is difficult to see any reason why an innocent principal should be held liable in those situations in which the third person has reason to doubt the agent's authority, but proceeds with the transaction anyway, and the law does not support such a result.

2. *"Agency powers."* The use of the term "agency powers" does not add to plaintiff's right to recover, if plaintiff could not reasonably infer from the agent's position that he had authority to offer the transaction in question.

The term "agency powers" referes to a concept used in the Restatement where the principal places a general agent in a position, such as that of a manager, and where the third party gains a reasonable impression of the agent's authority not from any communication from the principal, but from the agent's position itself (see Restatement of Agency 2d, Section 161). Most cases would refer to this situation as a type of

ostensible authority, since the principal, in permitting the agent to call himself a manager, is really communicating to the third party that the agent has such authority as can reasonably be inferred from that position. The Restatement, however, separates the two situations.

In any event, however, whether the situation is described in terms of "ostensible authority" or "agency powers," it is clear that the third party dealing with the agent must reasonably be able to infer from the position of the agent that the particular transaction is authorized.

Restatement, Section 161, the section dealing with so-called "agency powers," makes it clear that the Restatement's "agency powers" terminology does not in any way eliminate the requirement that the third party must reasonably believe the agent was authorized. Thus the section expressly provides, as a condition to the principal's liability, that the third party "reasonably believes the agent is authorized and has no notice that he is not so authorized."

Whether Mr. Kamen's permitting Mr. Ross to describe himself as the "Manager of the Broker-Dealer Department" is considered an act giving Ross certain "ostensible authority" or is described as creating in Ross certain "agency powers," the issue is the same—that is, the scope of that authority or those powers that could be reasonably inferred by plaintiff from the fact that Ross occupied that position.

Under the cases discussed above, it could not be reasonably inferred that Ross had authority to offer the transactions in issue.

3. *"Non-delegable duties."* This rather limited doctrine was developed to prevent the use of independent contractors instead of employees as a means of avoiding liability for the torts of workmen within the authorized scope of their job. It is generally available where the defendant is in a business involving danger to the public and requiring a license as a prerequisite to doing business. The doctrine was not designed to expand the areas in which a principal would be responsible for the torts of his agent, and this is quite plainly pointed out in at least two of the cases cited by plaintiff.

See, *e.g.*,

Snyder v. So. Cal. Edison Co., 44 Cal. 2d 798, 799-801 (1955);

Taylor v. Oakland Scavenger Co., 17 Cal. 2d 594, 604 (1941);

Thus, in the *Taylor* case, the California Supreme Court analyzed the doctrine as follows:

> "An employer is generally liable for negligent acts of employee performed within the scope of employment, but if an independent contractor rather than master and servant relationship exists, the independent contractor usually is alone liable for his negligent acts. If, however, an individual or corporation undertakes to carry on an activity involving possible danger to the public under a license or franchise granted by public authority subject to certain obligations or liabilities imposed by the public authority, these liabilities may not be evaded by delegating performance to an independent contractor."

And in the *Snyder* case, *supra,* the court made it clear that the doctrine of nondelegable duties merely puts independent contractors in the same position as employees, where the public interest does not justify the distinction.

Thus, the doctrine of nondelegable duties adds nothing to our case. Defendant Kamen & Co. already had the duties of an employer with reference to the acts of its employees. It could already be liable, for example, for transactions within the scope of its employee's actual or apparent authority. The fact that Kamen & Co. is licensed is irrelevant here. The fact might only prevent Mr. Kamen from avoiding all liability by hiring an *independent contractor* to perform his duties. In such event, he would be just as liable for the independent contractor's actions as he would have been for his own employees. But the doctrine of nondelegable duties does not in any way increase or decrease the responsibility of Kamen & Co. for its employees, which turns upon their liability on the general agency principles discussed above.

Hudson v. Nixon, 57 Cal. 2d 482, 484, also cited by plaintiff as involving nondelegable duties, involves an act by a husband who was held to be acting as agent for his wife and was considered to have acted within the scope of his employment. The Opinion does not, at any point, mention, refer to or rely upon the doctrine of nondelegable duties. It does not involve misrepresentations or fraud, in any event, and falls within the ordinary non-transactional tort cases covered by Restatement Section 219.

C. Since the Transactions Were Illegal and the Misrepresentations Would Not Be Actionable if Made by Appellants, They Cannot Be Liable for Such Acts by Their Agents.

Ross and Grossinger, who were also defendants but are not appellants, have not defended this action, and the District Court has found that they defrauded the plaintiff by impliedly representing to him that there was a market for the stock of Jerome Richards & Co., thereby inducing him to enter into the transactions under which he simultaneously bought and sold that stock at a pre-arranged gain in violation of the Stock Exchange Rules [Finds. 17, 18].

The question we now face is whether Appellants who were found not to have been participants in the fraud or to have been negligent in permitting it to occur, can properly be held liable for that fraud on the part of their agent.

It seems apparent that Appellants could not be held liable for their agents misrepresentations, if liability could not be imposed upon them had they made such misrepresentations themselves.

Without question, the acts of Ross and Grossinger were reprehensible and nothing we say here should be taken to justify those acts. Nevertheless, the agreement into which plaintiff was led by their fraud was plainly illegal, in that it violated the rules of the New York Stock Exchange, as the District Court found plaintiff well knew.

It is the view of Professor Williston that one who is induced by fraudulent misrepresentations to enter into an illegal agreement may not seek redress in the

courts based upon the fraud, unless the fraud is the sort that prevented him from ascertaining the facts that made the transaction illegal.

> 5 Williston on Contracts (Rev. Ed.), Section 1791, pp. 5089-5091.

Thus, Williston distinguishes *Randall v. California Land Buyer's Synd.,* 217 Cal. 594 (1933), permitting rescission of an illegal agreement for fraud, where (unlike our case) the fraud prevented the plaintiff from learning the facts creating the illegality.

A New York case has specifically applied the rule advocated by Williston to an action for deceit, dismissing the plaintiff's complaint to recover damages for fraudulent misrepresentations which induced him to enter into an illegal gambling transaction.

> *Landley v. Fischer,* 235 N.Y.S. 368, 369, 266 App. Div. 352 (1929).

Wallace v. Opinham, 73 Cal. App. 2d 25 (1946) has applied the *Williston* rule to illegal contracts in California. The *Wallace* case has been cited with approval by the California Supreme Court in *Hamilton v. Abadjian,* 30 Cal. 2d 49, 52 (1947) and followed in *Beach v. Arblaster,* 194 Cal. App. 2d 145, 160 (1961).

Not every jurisdiction has entirely accepted the New York and California view on this issue. The United States Supreme Court, in *National Bank & L. Co. v. Petrie,* 189 U.S. 423, 47 L. Ed. 879, 23 S. Ct. 512 (1902), permitted rescission for fraud regardless of possible illegality. The case may be explained by the fact that the plaintiff there did not know of the facts giving rise to the possible illegality, and, in any event,

the Court pointed out that the transaction "might have been lawful" and was "not necessarily wrong." (47 L. Ed. 880). To the extent that the case would permit rescission for fraud inducing an illegal transaction, it is criticized by Williston (5 Williston on Contracts [Rev. Ed.] p. 5090), and, in any event, is not necessarily applicable to an action for damages for deceit, as opposed to one for restitution.

In *Berman v. Riverside Casino Corp.,* 323 F. 2d 977 (9th Cir. 1963), this Court cited the *Landley* case as the law of New York and the *Wallace* case as the law of California. but held Nevada law to be to the contrary, at least as to gambling transactions.

The dealings between plaintiff and Appellants took place by telephone between California and New York. In this Brief and in our Opening Brief, we have cited both New York and California cases as well as decisions from other jurisdictions. There appears to be no direct conflict between New York and California law, and it seems clear that the law of one of these two jurisdictions would apply.

Since the District Court found plaintiff well knew the transactions violated the rules of the Exchange and the fraud did not prevent him from knowing the facts causing the illegality, the case is not like the *Randall* case, *supra,* but seems squarely within the *Landley* and *Wallace* cases. Accordingly, under the rule advocated by Williston, which apparently is at least the law in New York and California, plaintiff could not have held Appellants liable for damages had they directly induced him to take the illegal transactions offered by Ross and Grossinger.

This being so, the Court erred in holding Appellants liable for such acts committed by their agents, even if these acts were within the scope of their ostensible authority.

Certainly, if a defendant *in pari delicto* with the plaintiff in an illegal transaction is not liable for making misrepresentations inducing that transaction, it is *a fortiori* that an innocent defendant cannot be held for such misrepresentations made by his agents.

III.

The Court Did Not Err in Finding That Appellants Were Not Negligent.

The District Court found that Kamen & Co. was neither fraudulent nor negligent, that it exercised due care in the selection and supervision of its employees, and that it neither knew nor had reason to know of the fraud being carried out by Ross and Grossinger [Find. 24].

Plaintiff challenges the Court's finding that Kamen & Co. was not negligent. This finding, however, is strongly supported by the evidence in the record.

The thrust of plaintiff's attack on the finding is that plaintiff should have known, from the greatly increased volume of business that resulted from the services of Ross and Grossinger, that they were involved in some sort of improper activity (App. Br. pp. 45, 46). But the record does not warrant this conclusion and strongly supports the position of the District Court.

A brief review of the testimony may be helpful in this regard. It should be borne in mind that the Jerome Richards trades were not recorded in documents sent

to or from Kamen & Co. in that Kamen & Co. was not a party to any such transaction. Evidently, the only dealings in connection with this stock affecting Kamen & Co. were telephonic.

Before Ross and Grossinger were hired, Kamen & Co. had had little, if any, "wholesale business," that is, listed stock business referred from non-member broker-dealers, as opposed to the business of Kamen & Co.'s own customers among the public [Tr. p. 272]. Ross and Grossinger told Mr. Kamen they had taken a travling survey of broker-dealers throughout the country with reference to the type of service that would be attractive to such non-member firms, and that, if Mr. Kamen would put in special telephone equipment and offer free telephone lines and fast service in obtaining quotes and placing orders, as well as free use of various research materials, and the right to call upon Loeb Rhodes' "40 specialists" for immediate and free stock information, the non-member firms would refer to Kamen & Co. listed business in great quantities, and Ross and Grossinger expected that this could generate up to $300,000 in gross commissions per year [Tr. pp. 245-247].

Mr. Kamen knew his own firm selected over-the-counter brokers for its customers on the basis of price and good service [Tr. p. 280], and he thought that broker-dealers would choose a member firm on the basis of service in the same manner. He knew that his firm, being small, and having its own man on the floor, could put through orders and get quotes faster than Loeb Rhodes and the other large firms [Tr. pp. 257, 276, 404, 405]. This was confirmed by the testimony of Mr. Cohon [Tr. p. 380]. Mr. Kamen also knew that the

Loeb Rhodes specialist service would be a valuable thing and believed that, if he could combine this with his faster action and free telephone service, Kamen & Co. would indeed be giving the broker-dealers an attractive package. There is nothing in this that appears in any way unreasonable, it was confirmed by the testimony of Mr. Cohon, an expert of high qualification, and evidently was accepted by the District Court. In fact, there is no evidence in the record that much of the large volume of wholesale business produced after Ross and Grossinger came to work did not, in fact, come from the better and quicker services the company now offered. Perhaps the Jerome Richards rebates produced some of this increased volume, but there is no indication from the evidence that they were wholly or even primarily responsible.

Mr. Cohon testified that the volume promised and actually produced in the "wholesale" field by Ross and Grossinger was by no means extraordinary or suspicious [Tr. pp. 378, 381]. His own firm, for example, even though it discourages listed business, refers such business to member firms in quantities in excess of $300,000 per year. By getting his account alone, Ross and Grossinger could have reached their projected volume. Mr. Cohon also pointed out that he chooses his listed firms solely on the basis of service [Tr. pp. 378-380].

Mr. Cohon testified that such wholesale business normally produces far greater volume than direct dealing with the public, but can be far less profitable because of the enormous expenses involved, and that without a volume of at least $200,000. or $300,000., whole-

sale business would not pay at all. This would not be the case with retail business where expenses and volume would be lower [Tr. pp. 381, 395, 397, 398].

While the large volume realized would have given Ross and Grossinger commissions in a higher amount than most registered representatives receive, Mr. Cohon testified he would not consider it suspicious or even unique in the wholesale field. He pointed out that experience as a broker has little to do with success in soliciting accounts, that his company had a salesman who had earned $90,000. in commissions his first year in retail business, and that it was much easier to reach such figures in wholesale business [Tr. pp. 379, 398, 399].

If Mr. Cohon's testimony on this issue was accepted by the Court, and evidently it was, Mr. Kamen was certainly reasonable in believing Ross and Grossinger's statements and in seeing nothing suspicious in the fact that they produced the volume they had promised. If so, there plainly was no negligence.

But, even assuming that Mr. Cohon's testimony had been rejected and the testimony of plaintiff's expert, Mr. Townsend, had been wholly accepted, there would still be no negligence on the part of appellants Mr. Townsend said that, to him, the high wholesale volume would seem unusual, although "not impossible" [Tr. p. 317]. He would want to know how it came about. But the steps that Mr. Townsend testified would satisfy him are exactly those taken by Mr. Kamen. Mr. Townsend agreed that he would not listen in on employees

telephone conversations [Tr. p. 357] and that office supervision could not give him the answer [Tr. pp. 356, 357]. To him the only reasonable thing to be done would be to talk to "some" of the customers [Tr. pp. 357, 363]. Mr. Townsend's testimony in this regard showed that he would have been satisfied, had such customers indicated in conversation that they were pleased with the service, or words to that effect [Tr. pp. 357-364].

The record shows that Mr. Kamen did have such conversations with three of the customers, including one of his largest accounts. Each of these customers indicated that he was happy with the service and none indicated anything about Jerome Richard stock or that they were being given any form of rebate or improper transaction [Tr. pp. 405-407]. Surely, in light of such conversations, Mr. Kamen could reasonably believe the representations of Ross and Grossinger that the service Kamen & Company was offering and their contracts were producing the business, even if the expanded volume were considered unusual.

Appellee argues that Mr. Kamen should have detected the Jerome Richards transactions in the early part of 1963, when Ross and Grossinger occupied the "main room" at Kamen & Company and Mr. Kamen was separated from them only by a bannister. But this is contrary to the record. The earliest fraudulent Jerome Richards transaction shown by the record was in March of 1963 [Tr. p. 158], by which time Ross and Grossinger occupied a separate room. Ross and Grossinger

were in the main room, and separated from Mr. Kamen by a bannister, only in January and February of 1963 [Tr. pp. 211, 212]. In any event, the record does not show any substantial amount of Jerome Richards trades made by Ross and Grossinger *from Kamen & Co.'s office* at any time. The only evidence of any such trades being physically made from Kamen & Co.'s office by anyone was the testimony of Mrs. Ginsberg, Ross' secretary, that "occasionally" she was asked by Ross to make such calls [Tr. p. 433]. While Ross and Grossinger *may* have made some Jerome Richards calls from their room at Kamen & Co., this is not shown by the record, and it is entirely possible from the evidence they made their legitimate business calls from the Kamen offices and conducted their Jerome Richards business primarily from other places, such as the Jerome Richards office or the offices of others who may have been associated with them in the fraud.

Without going into further detail with respect to the rather large volume of facts presented on the issue of negligence, and the evidence of the thorough supervision Mr. Kamen exercised over the transactions going through his firm,* it seems clear that the record plainly supports the District Court's finding that Kamen & Co. and its partners exercised due care and were not negligent in preventing the fraud.

*A somewhat ironical note on the issue of negligence can be found in a comparison of Mr. Kamen's rigorous checks and controls over his firm's activities with the loose procedures followed by plaintiff in his own office. While Mr. Kamen personally checked every transaction going through his office every day, plaintiff (who protested that he was unaware of various things that were happening and documents that were passing through his office) appeared to exercise much less personal supervision, leaving many phases of his business to his employees [Tr. pp. 106, 107, 130.]

IV.

The Trial Court Did Not Err in Refusing to Admit the Affidavit of Francis J. Donnelly.

At the trial, the Court refused to admit Appellee's Exhibit 52, the affidavit of Francis J. Donnelly, an S.E.C. investigator, filed in support of an injunction sought by the S.E.C. in a Civil Action in the United States District Court.

The affidavit on its face (at page 2) states that "the facts set forth in this affidavit are alleged *on information and belief*" (emphasis added) based upon inspection of certain records and on certain interviews. It is evident from the record [Tr. 269; 547-549, and from App. Br. p. 47] that the primary purpose for which plaintiff sought the admission of said affidavit is that paragraph 39 thereof contains affiant's statement of what a Mr. Crowe (not a defendant) told Mr. Donnelly on some other person that defendant Kamen had stated in an alleged conversation with Crowe. That, of course, is a flagrant example of hearsay on hearsay. The remainder of the affidavit dot only consists solely of matters about which the affiant had only second hand knowledge, but matters which were already before the trial court in a proper manner [Compare Affidavit, para. 19 with Tr. 432-437; 438; 441-442; 150-151; 171; 174; Compare Affidavit, para. 16 with Tr. 261-264; 430;431].

Appellee argues that the affidavit should have been admitted as an official document prepared by Mr. Donnelly pursuant to the statutory obligation of the S.E.C. to investigate possible violations of the Securities Act and the Securities & Exchange Act. He cites *Model*

Code of Evidence, Rule 515, and cases from the 2nd, 6th, 3rd, and 10th Circuits in support of the proposition that the affidavit is admissible.

However, the Ninth Circuit case of *Olender v. United States,* 210 F. 2d 795, 800 (9th Cir. 1954), clearly holds that hearsay rule precludes admission of such affidavits notwithstanding the official document exception. Thus, the Court states at page 800:

> "Since the official documents are a substitute for the personal appearance of the official in court, it is generally held that such documents, to be admissible, must concern matters to which the official could testify if he were called to the witness stand. *Vanadium Corp. of America v. Fidelity & Deposit Co. of Maryland,* supra, 159 F2d at page 109; *5 Wigmore on Evidence,* § 1635 (3rd Ed.). *Thus, this circuit and most of the other circuits which have passed on the question have held that the facts stated in the document must have been within the personal knowledge, and observation of the recording official or his subordinates, and that reports based upon general investigations and upon information gleaned second hand from random sources must be excluded."* [Citations omitted.] [Emphasis added.]

This Court, in the *Olender* case, has already considered the cases and *Model Rule* relied on by Appellee, and at Footnote 1, page 801, expressly rejected them. Moreover, the nature of the document Appellee seeks to have admitted in this case demonstrates the soundness of the *Olender* rule. The investigator's report can hardly be considered sound evidence when it was all based on hearsay and was prepared solely for the pur-

pose of supporting an injunction in a civil action . . . hardly an impartial context.

Appellee also argues that *Olender* has been "sapped of much of its vitality by *Canada Life Assurance Company v. Houston,* 241 F.2d 523 (9th Cir. 1957)." That case involves the admissibility of a coroner's jury verdict and coroner's death certificate. Not only did the documents in that case not involve hearsay, since they merely stated "cause of death unknown," but a final adjudication of a body competent to render such decisions is wholly distinguishable in quality and reliability from an investigator's affidavit advocating a proposed decision. Moreover, the *Canada Life* case simply relied on a 1934 case (*Connecticut General Life Insurance Co. v. Maher,* 70 F. 2d 441, 444 (9th Cir. 1934), without comment and without decision on its effect or relationship to the *Olender* case which fully considered the merits of the issue here present. Even one of the cases relied on by Appellee, *Franklin v. Skelly Oil Co.,* 141 F. 2d 568, 572 (10th Cir. 1944), recognizes that different standards of admissibility apply to findings and results of public hearings and inquests than those applicable to investigators' reports. The former is obviously more reliable and worthy of admission, at least for limited purposes and in the discretion of the trial court.

Finally, it is apparent that, whether or not the document should have been admitted, it was not prejudicial error to have excluded it. Appellee argues that the document could show the number of brokers involved in the manipulation of the Jerome Richard stock, but the record clearly establishes that the trial judge was aware that many brokers were so involved. Plaintiff had two

brokers so testify, introduced depositions upon written interrogatories of three others, and elicited the stipulation that still other brokers were involved. [Tr. 432-437; 438; 441-443; 150-151; 171; 174]. Appellee also points to the reference in the affidavit to the so-called extended presence of Mr. Herman in defendants' office. The record clearly reflects that such evidence was directly introduced and the affidavit would merely have been cumulative [Tr. 261-264; 430-431]. Even the alleged Kamen—Crowe conversation, which under no circumstances should be admissible as it violates every test of admissibility and wholly vitiates the right to cross-examine, is not particularly significant. There was ample evidence of the practice of referring reciprocal business. Therefore, even if the alleged conversation had taken place, a statement by a broker that he was not getting enough reciprocal business, could not be significant. Since the trial judge heard three full days of testimony bearing upon the various issues covered by the affidavit, its rejection could not be deemed prejudicial.

Finally, the transcript, at pages 547-549, clearly discloses that the trial judge properly ruled on the admissibility of the document. He refused to admit it to prove the truth of the statements made by persons other than Kamen. Under any rule, it would seem that Kamen should have the right to cross-examine the persons making such statements with respect to the truth thereof. With respect to the other matters for which Appellee now claims he sought admission of the document, Appellee failed to point out those portions of the document to the trial judge, or to request admission of only such portions of the document as he may argue were admissible.

Accordingly, the trial judge did not err in refusing to admit the document, and even if he did, the error was not prejudicial.

V.

Conclusion.

Over the years, agency cases have toiled with the problem of which of two innocent parties, the principal or the third party dealing with the agent, should bear the loss resulting from an agent's exceeding his authority.

See,

1 Mechem, *Agency,* pp. 528-532.

Some authorities would place the loss on the third party dealing with the agent, since he could have prevented the loss by checking with the principal as to the scope of the agent's actual authority.

1 Mechem, *Agency,* p. 532;

E.g., Ernst v. Searle, 218 Cal. 233, 240 (1933).

Other cases have felt that, both parties being equally innocent, the principal, who selected the agent, should bear the loss.

E.g., County of Macon v. Shores, 97 U.S. 272, 279, 24 L. Ed. 889, 890 (1877).

But this problem exists only where there is innocence on *both* sides—a situation not present in our case. Appellants were found by the District Court to have been neither fraudulent nor negligent, to have neither known nor had reason to know of the transactions in issue. They did all they reasonably could have done to prevent such occurrences.

Plaintiff, on the other hand, was not innocent. He was a broker of long experience. The District Court found that he well knew the transactions violated the Stock Exchange Rules at the time he accepted them. He knew they were unusual and that they could result in the imposition of serious sanctions against appellants. He could easily have checked on the authority of Ross and Grossinger to offer such illegal transactions and thus would have prevented the entire loss. He chose not to do so, but to go forward with these improper transactions to collect his quick and unearned profit.

Surely then, fairness and equity call for the burden of the loss to be borne by plaintiff, rather than by appellants, who had no reason to know these transactions were occurring and no reasonable way to prevent them.

Since, on the facts as found by the District Court, the authorities call for the same result, and, since the District Court quite apparently was applying incorrect legal standards in its determination that apparent authority existed and appellants should be liable, we respectfully suggest that the judgment should be reversed.

Respectfully submitted,

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BERTRAM FIELDS and
BERNARD SHEARER,
Attorneys for Appellants.
and Cross-Appellees.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

BERTRAM FIELDS

No. 19923

IN THE

United States Court of Appeals For the Ninth Circuit

DICKMAN LUMBER COMPANY,
a Washington corporation,
Appellant,

v.

UNITED STATES OF AMERICA,
Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE GEORGE H. BOLDT, *Judge*

REPLY BRIEF OF APPELLANT

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IN THE

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APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE GEORGE H. BOLDT, *Judge*

REPLY BRIEF OF APPELLANT

APPELLEE'S COUNTER-STATEMENT OF THE CASE

In its counter-statement of the case, the appellee, as did the District Court in its oral decision and findings, omitted and ignored facts which were material to the plaintiff's case and which were established by the undisputed evidence. Such material facts, which are for the most part established from the matters set forth in plaintiff's Exhibit 2 and other exhibits which were admitted into evidence, on stipulation, from the deposition of R. L. Dickman, Sr., who was unable to appear in Court by reason of physical disability, and whose testimony

was taken on written interrogatories and cross-interrogatories, and from the underscored portions of the affidavit of Donald L. Doud (R. 172), which were admitted by the appellee (R. 179) are set forth as follows:

(1) Large purchases or negotiations for purchases of private and state timber on non-scale lump sum cash basis (Ex. 2).

(2) Loans made or arranged for in bidding on or purchasing at such non-scale lump sum cash sales (Ex. 9; Dep. 40, 41).

(3) Competition in purchase of federal and state timber intensified by Japanese exports (R. Tr. 59-61, 192, 200).

(4) Due to the rapidly diminishing and depleted timber supply, the continued existence of the appellant required that it purchase all available timber suitable for its mill which could be acquired at a price which would produce a profit (Dep. 28; R. 167, 168).

(5) Ratio of Douglas fir upon which appellant depends for profitable production of specialties, to hemlock and related species of timber, progressively decreasing (Ex. 2; Dep. 29).

(6) Adequate supply of Douglas fir logs for appellant's operations unobtainable on the open market (Ex. 2; Dep. 29, 30).

(7) Annual dollar log requirement of appellant consisting of one-half fir and one-half hemlock amounts to the approximate sum of $1,500,000.00 (Dep. 25).

(8) Progressive increase in cost of stumpage and of log production at appellant's mill (Dep. 24).

(9) Volatile and fluctuating prices on lumber products produced by appellant (Ex. 4).

(10) Statements of appellant's officers of reasons for not declaring larger dividend at end of 1959 in overcoming presumption that appellant corporation

was availed of for the purpose of avoiding taxes on its shareholders (Dep. 38, 39; R. Tr. 70, 71).

(11) No assessment of accumulated earnings tax until 1959, although appellant's income tax returns for previous years showed large profits and comparable liquidity and were audited each year (R. Tr. 206-211).

Even though the appellee's counter-statement of the case is strictly limited to the findings made by the District Court (R. 180-190), certain statements are made which cannot stand unchallenged since such statements are incomplete and inaccurate. Thus, we find on page 8 of appellee's brief "The December 31, 1959, holdings of logs and timber were in excess of taxpayer's one-year capacity for the production of lumber." The evidence will not support the appellee's asserted inference that a one-year supply of logs and timber was sufficient to assure the appellant's continued existence with an ever-increasing and undiminishing supply of raw materials. As a matter of fact, the undisputed evidence discloses that the appellant should acquire all logs and timber within its means which would be suitable for its mill and could be purchased at a price which would produce a profit (Dep. 28). The Berry Creek No. 3 sale appellee refers to as having a potential of 19,400,000 feet of timber at the end of 1959, as a matter of fact produced only 13,728,030 feet of logs B.M. with an underrun of 5,671,970 feet B.M. (Ex. 13). Again, on page 9 of appellee's brief, it is stated that the loss sustained by appellant in 1958 amounted to the sum of $590,491.00,

which was largely due to the Fernandez log and timber purchase transactions, but that the appellant's uncollectible judgment against Fernandez was written off in 1958 for tax purposes and resulted in a higher over-all loss for 1958. Then appears the following language on page 10:

> "This substantial loss, therefore, was not for the most part a reflection of normal operations, but was due to one extraordinary situation."

The actual Fernandez bad debt loss allowed in 1958 amounted to the sum of $462,000.00 (R. St. 156), and resulted in a total loss for that year, as adjusted by the Internal Revenue Service, of $590,491.00. Under such adjustment the appellant had a net operating loss in 1958 of $128,491.00. Any portion of this operating loss allocated to depreciation was on the "straight line depreciation basis" since the "accelerated depreciation method" was not adopted until 1961 (R. Tr. 138).

On page 10 of its brief, the appellee attempts to minimize the losses sustained by the taxpayer for the years 1960, 1961 and 1962, as shown by the income tax returns, by setting forth the depreciation deductions, the amount of the salaries payable to R. L. Dickman, Sr., and his son, R. L. Dickman, II, for each of said years, and it is further stated that there was an outstanding balance of $30,934.94 in advances to officers, and an accrued income tax claim receivable of $308,278.75 for the year 1960. The Fernandez and Kelly bad debt write-

offs in the sum of $84,355.75 in the year 1962 are also set forth in minimizing the 1962 income tax losses.

The depreciation, salaries and bad debt write-offs were approved in the income tax audit for each of the three years in question as proper deductions under the Internal Revenue Code and Regulations. At the end of 1959, the advances to officers were limited to the sum of $9,192.00 and at said time the officers of the corporation had no knowledge of the income tax receivable in the sum of $308,278.75 since the Fernandez 1958 bad debt loss was not approved or agreed to by the Internal Revenue Service until the issue of the agent's report dated October 21, 1961. The sum of $30,934.94, which is stated to be the total amount of the advances to officers at the end of 1960, were debts due the corporation from the officers and were evidenced by promissory notes (R. Tr. 110, 111).

SUMMARY OF REPLY TO ARGUMENT OF APPELLEE

This reply is directed to the five following issues raised by the appellee's answering brief:

I. Review of entire record foreclosed under "clearly erroneous rule."

II. Liquidity of appellant.

III. That appellant could obtain all logs required from the open log market and from purchase of state and federal timber on installment payment basis.

IV. That the retirement of stock under Section 303

was personal to the Dickmans and did not constitute a corporate need; and

V. That appellant has not questioned or overcome presumption that the corporation was availed of to avoid income tax on shareholders.

I.

Review of Entire Record Not Foreclosed Under "Clearly Erroneous Rule"

On page 20 of its brief, under the subtitle "Standard of Review," the appellee sets forth the general principle that, "unless the District Court's findings, including its inferences from undisputed facts, are clearly erroneous or induced by an erroneous view of the law, they must be upheld." The case of *Commissioner v. Duberstein,* 363 U. S. 278, 80 S. Ct. 1190, 4 L.Ed.2d 1218 (1960), is cited, together with other authorities in support of this rule.

The appellant asserts two grounds in support of its contention that there should be a review of the entire record. First, the District Court, in its oral decision and findings, omitted and ignored facts which were established by the undisputed evidence and which were material to the appellant's case, as shown on pages 2-3 of this brief. Second, the District Court failed and neglected to find the facts specially and state the conclusions of law with clarity in its memorandum decision as required under Rule 52(a) Fed. Rules of Civ. Proc. In this connection, we again refer to the case of *Roberts v. Ross,* (3 C.A. 1965) 344 F.2d 747, cited in appellant's

opening brief, which states that the findings and conclusions as set forth in the lower court's memorandum decision must be sufficient to indicate the basis of the Judge's decision.

The most casual reading of the District Court's oral decision (R. 198) will disclose that it not only deals with broad generalizations which are vague and not particularly germane to the issues involved, but that there is a failure to make specific findings on all of the material facts covered by the evidence in the case. The nearest approach to a specific finding as required under Rule 52(a) are the statements that the cash assets and accumulated earnings in prior years were sufficient to meet the reasonable needs of the business and that "the evidence does not preponderate to show that there was a reasonable business necessity for retaining the $129,000 odd portion of earnings retained in 1959."

In connection with the appellant's contention which was urged throughout the proceedings that the accumulation of earnings to pay federal estate and inheritance taxes, etc., was a reasonable need of the business, the District Court stated:

> "However, I want to make it plain I am not deciding as a matter of fact or law whether the estate tax requirements justify the earnings retention in question in whole or in part." (R. 201).

It should be borne in mind that the only change made in the original findings submitted by the appellee (R. 115), was the incorporation by reference on page 1 of

the Court's findings finally entered (R. 180) of the Court's memorandum decision. The quoted portion is clearly inconsistent with Finding 25 (R. 188) in which it is stated that the redemption of stock under Sec. 303 served no corporate purpose and indicated a purpose to accumulate earnings and profits in 1959 in excess of those reasonably needed in order to avoid income tax on its shareholders. From these inconsistent statements it is difficult to determine just what the Court finds or concludes on the Section 303 question. These inconsistencies certainly constitute an ambiguity and are in violation of the duties of a trier of the facts under Rule 52(a) as outlined in the case of *Roberts v. Ross, supra.*

With respect to the duties of the trier of the facts, in making specific findings under Rule 52(a), the contrast should be noted between the detailed and specific findings made by the District Court in the case of *Cummins Diesel Sales of Oregon, Inc., v. United States,* as reported in 207 F. Supp. 246, and the lower court's memorandum decision in this case. The Circuit Court of Appeals for the Ninth Circuit affirmed the lower court's decision under the "clearly erroneous rule" in *Diesel Sales of Oregon, Inc., v. United States,* 321 F.2d 503, and the appellee strongly relies on this case in support of this contention that there should be no review of the entire record, but that the Circuit Court's inquiry should be limited to the Court's memorandum decision and the findings of fact and conclusions of law as entered by the

Court. In support of its position the appellee has also cited the case of *Commissioner v. Duberstein, supra.* In this decision there was a consolidation of two cases, both of which required a determination of whether a transfer of property was a gift excludable from the recipient's gross income for income tax purposes. The second case (No. 546) involved a cash payment by a church to the taxpayer upon his resignation from a church office. The District Court as the trier of fact made only the simple and unelaborated finding that the transfer in question was a "gift." The Supreme Court held that this finding was insufficient and the case was remanded to the District Court for further finding. Language from the *Duberstein* case is quoted in the footnote.[1]

II.

Liquidity Factor

From an examination of the Court's oral decision (R.

1. "To four of us, it is critical here that the District Court as trier of fact made only the simple and unelaborated finding that the transfer in question was a 'gift.' To be sure, conciseness is to be strived for, and prolixity avoided, in findings; but, to the four of us, there comes a point where findings become so sparse and conclusory as to give no revelation of what the District Court's concept of the determining facts and legal standards may be. See *Matton Oil Transfer Corp. v. The Dynamic* (CA 2 NY) 123 F.2d 999-1001. Such conclusory, general findings do not constitute compliance with Rule 52's direction to 'find the facts specially and state separately . . . conclusions of law thereon.' While the standard of law in this area is not a complex one, we four think the unelaborated finding of ultimate fact here cannot stand as a fulfillment of these requirements. It affords the reviewing court not the semblance of an indication of the legal standard with which the trier of fact has approached his task. For all that appears, the District Court may have viewed the form of the resolution or the simple absence of legal consideration as conclusive. While the judgment of the Court of Appeals cannot stand, the four of us think there must be further proceedings in the District Court looking toward new and adequate findings of fact." (363 U.S. 292, 4 L.Ed.2d 1229)

198), it is obvious that, after stating that it would not make either a finding of fact or conclusion of law on appellant's contention that the accumulation for the retirement of stock under Section 303 was a reasonable need of the business, the Court rendered its decision on the sole ground that appellant had sufficient liquid assets at the end of 1958 to take care of the reasonable needs of the business, and that that part of the 1959 net earnings in the sum of $129,031.12 which constituted the base upon which the accumulated earnings tax was assessed, was not required for such reasonable needs and should have been declared as dividends.

Since the District Court's decision, the United States Circuit Court of Appeals for the Second Circuit has handed down a decision in the case of *Electric Regulator Corporation v. CIR*, (2 C.A. 1964) 336 F.2d 339, which it is urged is applicable to the liquidity question. In that case the corporate taxpayer, which manufactured electric control devices, was organized in 1945 by the two principal shareholders, with an original total investment limited to the sum of $2,180.00. From the time of its organization up to the time of the assessment of the accumulated earnings tax for the years 1957 and 1958, taxpayer had expended considerable sums of money in the expansion of its plant. During the twelve years of its existence, the taxpayer had acquired assets totaling more than $1,000,000.00 and during all of its existence had never paid a cash dividend. Current assets and lia-

bilities for the years 1957 and 1958 were as follows:

1957	Current Assets	$1,219,292.00
	Current Liabilities	600,569.00
1958	Current Assets	864,104.00
	Current Liabilities	252,240.00

The earned surplus from 1955 through 1959 was as follows:

1955	$474,139.00
1956	532,663.00
1957	754,191.00
1958	848,006.00
1959	932,026.00

The combined salaries of the two principal shareholders and officers of the corporation, namely, the President and Treasurer, for the years 1955 through 1959, were as follows:

1955	$ 51,000.00
1956	94,915.02
1957	108,500.00
1958	90,011.92
1959	78,380.42

The only loans to shareholders were made in 1957 and 1958 and were limited to $3,000.00. The taxpayer had never sustained losses from the time it commenced business. The future prospects for sales and profits were good. The Commissioner of Internal Revenue assessed an accumulated earnings tax in the sum of $81,751.01 for 1957 and $25,944.69 for 1958.

Taxpayer paid the taxes and sued for a refund in the Tax Court which held in *Electric Regulator Corporation*

v. CIR (N.Y. 1963), 40 U.S.T.C. 757, in favor of the Commissioner. The decision was based largely on Section 1.535-3(b)(ii) of the Internal Revenue Regulations. A quotation from the decision is set forth in footnote.[2]

The U. S. Court of Appeals for the Second Circuit reversed the Tax Court on the two following principal grounds: First, the Company's earned surplus had been converted into improvements, machinery, equipment and inventory and was not available for current expenses to say nothing of dividends and, for that reason, was not subject to the tax. Second, the Company had no more cash on hand than was adequate since, in this day of technological change, specific sums cannot always be earmarked or set aside in advance to achieve a specific goal. Language from the decision of the Second Circuit is set forth in the footnote.[3]

2. "Thus it will be seen that, if the earnings and profits of the current year are required to be retained for the reasonable needs of the business, this may provide a possible shield against the imposition of the accumulated earnings tax. But on the other hand, if the reasonable needs of the business can be satisfied from the earnings and profits already accumulated in prior years, there is no necessity for retaining any portion of the current year's earnings and profits to satisfy such needs. Hence, if that is true the earnings and profits of the current year may be found to be accumulated beyond the reasonable needs of the business, and the right to any credit based upon the reasonable needs of the business may be destroyed.

From what has been said above, it is at once apparent that the size of the accumulated earnings and profits from prior years (often called earned surplus or simply surplus) is an important factor. Yet such surplus cannot be viewed in isolation." (40 USTC 765)

3. "In addition to finding that accumulated earnings and profits provided a sufficient 'cushion' for present and future needs, the Tax Court concluded that petitioner had adequate cash with which to pay out all of its 1957 and 1958 net earnings in dividends. We conclude that this holding was also clearly erroneous. Again, it is apparent that balance sheet totals rarely, if ever, tell the whole story. Only after close analysis

of the nature of the cash account and the present and anticipated demands which it will be forced to meet, can a trier of fact venture a finding that the liquid assets justify the declaration of a dividend. Nothing in the Internal Revenue Code prohibits large cash balances where the taxpayer has sufficient need for the cash in its business. Although it maintained a cash account of substantial magnitude, the evidence is plain that petitioner's needs for cash were real and that any accumulation was fully justified. * * *"

* * *

"Petitioner's rapid and well-managed growth in a highly competitive industry hardly presents the picture of a tax-saving device. Its earnings have not been allowed to lie fallow; rather, they have been plowed back into the corporation in the form of new plant and other income producing assets. It has developed new product lines and actively sought to expand its markets, compare *Smoot Sand & Gravel Corp. v. Commissioner, supra,* 274 F.2d at 497-98."

* * *

"If the Tax Court's views here were to be accepted, they would give to the Treasury virtually absolute power to stifle or encourage economic growth as it—not the corporate directors—decided how each company should handle its corporate and financial affairs. The Courts are not unmindful of the efforts of the Department of Justice through its Anti-Trust Division to encourage competition by attacking monopolistic practices which might be harmful to smaller units of industry, and of Congress' decided interest in small business and its development. It would be anomalous indeed were the Treasury to have the power to thwart these praiseworthy objectives. But equally praiseworthy is (and should be) the Treasury's vigilance lest a corporation, particularly a private or family-owned corporation with only a few stockholders, be used to prevent the imposition of high taxes on such stockholders."

"To resolve this possible conflict, a careful examination of the facts of each case must be made. The circumstances in a number of cases decided by this Court in recent years are markedly different from those found here. In *The Factories Investment Corp. v. Commissioner,* 328 F.2d 781 [13 AFTR2d 880] (2d Cir., 1964) neither dividends nor salaries were ever paid. In *Oyster Shell Prods. Corp. v. Commissioner,* 313 F.2d 449 [11 AFTR2d 777] (2d Cir., 1963) loans were made to shareholders, and investments were made in the stock of unrelated corporations. In *Youngs Rubber Corp. v. Commissioner,* T.C. Memo, 1962-300, aff'd, 331 F.2d 12 [13 AFTR2d 1251] (2d Cir., 1964) large reserves were kept accumulated for personal, not corporate, purposes and moneys were set aside for specific uses which never materialized. On the other hand in *R. Gsell & Co., supra,* the need for the accumulation was obvious."

"Mindful of the possibility of the misuse of the corporate form and the careful examination which must be made when no dividends have been declared by those in control of a closely-owned corporation, we have, under these facts, no hesitancy in declaring our 'definite and firm conviction' that the Tax Court was in error in concluding that Petitioner was availed of for the prohibited purpose. See *United States v. U. S. Gypsum Co.,* 333 U.S. 364, 394, 68 S. Ct. 625, 92 L.Ed. 746 (1947)." (336 F.2d 344-346)

In comparing the facts of the *Electric Regulator Corporation* case with the instant case, the following differences should be noted and given the proper weight: In the *Electric Regulator* case, there had never been a declaration of cash dividends. In the instant case the plaintiff had declared and paid dividends over the years as recognized by the District Court's Finding No. 12 (R. 183). In the cited case the combined salaries of the two principal shareholders and officers of the corporation, namely, the President and Treasurer, was the sum of $108,500.00 for the year 1957, and the sum of $90,-011.92 for the year 1958, the two years for which the accumulated earnings tax was assessed. Here, the combined salaries of the two principal shareholders and officers of the corporation for the year 1959 was limited to the sum of $47,000.00, of which amount R. L. Dickman, Sr., received $30,000.00 and his son, R. L. Dickman, II, received $17,000.00. In this connection it must be borne in mind that the appellant was a much larger corporation than the Electric Regulator Corporation, both from the standpoint of book value of assets and the dollar value of raw materials processed, as well as volume of manufactured products and manufacturing and sales activities. While the loans to shareholders in the cited case was limited to the sum of $3,000.00, the loans to the two principal shareholders and officers of the Dickman Lumber Company only amounted to $9,192.00 in 1959. The Electric Regulator Corporation never sustained a loss during the twelve-year period of existence,

while here the appellant corporation had sustained losses for the years 1958, 1960, 1961 and 1962. In comparing the facts of the two cases, it is further pointed out that in the *Electric Regulator* case the future outlook for increased profits and sales was most optimistic. In this case the future prospects for profitable operations are decidedly doubtful.

Since the entry of the judgment by the District Court in the instant case, the three following cases which have been decided by the Tax Court are applicable to this issue:

John P. Scripps Newspapers (Filed 6/25/65)
44 T. C. 41

Freedom Newspapers, Inc. (Filed 9/15/65)
T. C. Memo 1965-248

Bremerton Sun Publishing (Filed 7/16/65)
44 T. C. 53

On page 338 of the *John P. Scripps Newspapers* case, *supra,* and at page 420 in the *Bremerton Sun Publishing* case, *supra,* the Tax Court resorts to the same language as quoted below in discussing the rule of thumb doctrine which has been employed by the courts in determining whether a corporation's working capital requirements are sufficient to meet its needs.[4]

4. "As an aid in determining whether a corporation's working capital requirements are sufficient to meet its needs, resort has been had to certain general 'rules of thumb.' It has been held that a ratio of current assets to current liabilities which is in the neighborhood of 2½ to 1 is an indication of a reasonable accumulation of surplus. *John P. Scripps Newspapers, supra.* Cf. *R. C. Tway Coal Sales Co. v. United States,* 3 F. Supp. 668 (12 AFTR 1073) (W.D.Ky. 1933) affd. 75 F.2d 336 (15 AFTR 189) (C.A. 6, 1935); *Sandy Estate Co.,* 43 T.C. 361 (1964);

The problems in *Freedom Newspapers, Inc., supra,* are quite parallel to the problems confronted in this case, and that decision is the latest expression by the Tax Court on this issue. There the corporate taxpayer owned a chain of newspapers in California and the southwestern part of the United States. Accumulated earnings taxes were assessed for the years 1959 and 1960. The corporation had a net working capital in 1959 of $3,229,-222.00, with a ratio of current assets to current liabilities of 4.28 to 1. In 1960 it had a working capital of $3,803,-864.00, with a ratio of current assets to current liabilities of 5.81 to 1. The taxpayer took the position that its accumulated earnings in the years in question were required in carrying out its expansion plans of acquiring additional newspapers and as a cushion for possible anti-trust liability. While the Commissioner recognized the propriety of retaining earnings for the expansion of a corporation's business under Section 1.537-2(b) of Treasury Regulations, it urged that the taxpayer had no "specific and definite plans" to use the accumulation for its

Sterling Distributors, Inc. v. United States, 313 F.2d 803(11 AFTR2d 767) (C.A. 5, 1963), *Breitfeller Sales, Inc., supra; James M. Pierce Corporation, supra.* The other rule of thumb sometimes resorted to states that an accumulation of earnings to meet operating expenses for at least one year is reasonable. *F. E. Watkins Motor Co., supra; J. L. Goodman Furniture Co., supra; James M. Pierce Corporation, supra.* However, it has been said that working capital requirements of one business are not necessarily the same as another business and that therefore the rule of thumb should not be given any greater weight than a rule of administrative convenience. *Dixie, Inc. v. Commissioner,* 277 F.2d 526 (5 AFTR 2d 1239) (C.A. 2, 1960), affirming 31 T.C. 415 (1958), *certiorari* denied 364 U.S. 827 (1960); *Barrow Manufacturing Company v. Commissioner,* 294 F.2d 79 (8 AFTR2d 5330) (C.A. 5, 1961), affirming a memorandum opinion of this court, *certiorari* denied 369 U.S. 817 (1962)." (44 P.H.-T.C. 338, 420)

expansion needs. See footnote for Tax Court's answer in holding that the accumulation of earnings was not beyond the reasonable need of the business.[5]

It will be further noted from *Freedom Newspapers, Inc., supra,* that, while there were no loans to its stockholders, the corporation paid no dividends at any time and liberal salaries were paid to the principal shareholders and officers. As has been stated by the Court of Appeals for the Second Circuit in the *Electric Regulator Corporation* case, *supra,* the economic growth and welfare of a corporation should be a factor to be considered in determining whether there should be an assessment of the accumulated earnings tax.

If appellant is to remain alive and continue its lumber manufacturing operations, it must have a definite and steady supply of raw materials in the form of logs or timber suitable for its mill. While sales of federal timber and a large part of the present sales of state timber are on a "pay-as-you-go" basis, still there are sales of both state and private timber which come up from time to

5. "In two recent cases, *John P. Scripps Newspapers, supra,* and *Bremerton Sun Publishing Co.,* 44 T.C. 566 (1965), this court has recognized that the 'definite and certain' requirements with respect to plans of expansion must be analyzed in the context of the particular business involved. Therefore, the specificity of petitioner's plans for expansion must be judged in the light of the problems common to the newspaper business and the acquisition of newspapers. These problems are in a sense unique. A newspaper in no way resembles a fungible commodity. A prospective customer cannot merely place an order or draw plans, as for a piece of machinery or additional construction. He can do no more than actively search out opportunities for acquisition, either personally or through brokers. However, there is no assurance that his investigation and negotiations will culminate in an acquisition of any particular newspaper in any particular month or year." (P.H.-T.C. Memo, 1965—248 at 1465)

time on a lump sum cash basis (Ex. 2). Good business practice should dictate that the appellant have on hand at all times ample cash reserves to purchase all timber available at such sales which is suitable for appellant's mill and which can be manufactured into lumber at a profit. Certainly, the appellant should not be expected to obtain bank loans and incur interest charges in order to make such purchases. If the Company is unable to invest its cash reserves in the profitable purchase of logs and timber inventories, the high ratio between current assets and current liabilities will continue and in any year that the corporaton earns net profits it will be exposed to the accumulated earnings tax on the strength of the lower court's decision if the same is affirmed. It should be noted here that the net operating loss carrybacks and carryovers under the 1954 Code are not deductible for the purpose of computing accumulated taxable income under Section 535(b)(4). Certainly there is little incentive for small mills, without permanent stands of timber, to continue operating in a competitive industry if any future earnings or profits may be subjected to this penalty tax. A sensible answer would seem to be a dissolution of the corporation and a distribution of its assets to shareholders while it still enjoys a highly liquid position. Such a termination of the Company with the resultant loss of a substantial payroll to the area and potential loss of income tax revenue would be directly contrary to the decision and rationale of the *Electric Regulator Corporation* case.

III.

Supply of Logs Obtainable on Open Market, Together With Logs Produced From Possible Purchases of State and Federal Timber on Installment Basis Is Not Sufficient to Permit Expansion or a Continued Profitable Operation by Appellant

Commencing on page 32 of its brief, under the subtitle, "Mill requirement of logs and timber," the appellee argues that the logs available on the open market, together with those produced from timber which can be purchased at sales of state and federal timber on an installment basis are adequate to fulfill the appellant's log requirements. Again, on page 35 of appellee's brief, it is stated, "The December 31, 1959, holdings of logs and timber were in excess of . . . (taxpayer's) one year's capacity for the production of timber (I.R. 185). Taxpayer does not challenge this finding; nor can it do so on the record."

On page 23 of its brief the appellee admits that appellant required from 22 million to 25 million feet of logs each year, and that, as a well-known producer of certain specialty items for which there was a constant demand, it looked primarily to Douglas fir as the source of supply for the manufacture of such specialty items.

The following schedule of purchases of all federal and state timber from 1958 through 1963 has been prepared from the factual data set forth in Exhibit 2, based on federal and state estimates, all of which were made on an installment basis with the exception of the 1958 pur-

chase known as "Sale No. 966" (Greenwater) which was made on a non-scale lump sum cash basis of $531,000.00 and which, among other things, shows the ratio between the Douglas fir and hemlock and related species covered by such sales:

Description of Sale	*Date of Purchase*	*Total Volume Ft. B.M.*	*Volume Douglas Fir Ft. B.M.*	*Pg. Rec. Ex. 2*
		1958		
No. 966 (Greenwater)	8/25/58	11,341,000	8,555,000	4
		1959		
Berry Creek No. 3	12/23/59	19,400,000	3,300,000*	11
		1960		
Rocky Run	4/19/60	11,806,000	4,795,000	5
Rocky Brook Ridge	9/28/60	11,200,000	6,900,000*	12
Upper Rocky Brook	12/28/60	2,900,000	1,700,000*	12-13
		1961		
Hazzard Creek	12/28/61	9,500,000	5,000,000	13
		1962		
Rock Run Blow Down	6/25/62	3,244,000	1,082,000	5-6
Mud Lake	8/27/62	1,194,000	818,000	6
East Valley Sale	12/26/62	12,300,000	5,400,000	14
		1963		
Gut Mountain	5/27/63	8,016,000	1,977,000	7
Lower Greenwater	12/30/63	5,860,000	4,200,000	15

*Estimate includes western white pine with undetermined volume.

In connection with the foregoing schedule, reference should be made to Exhibit 13 which shows the undercut and overcut on seven out of the total of eleven purchases covered. Mr. Sambila, who is employed by appellant as a timber purchaser, testified that at the time of trial in sales of federal timber by the U. S. Forest Service "that the remaining stands of timber comprised 20 per cent Douglas fir and the remaining in white fir, Noble fir and hemlock" (R. Tr. 201).

Profits on the sale of lumber manufactured from hemlock and related species of timber are much lower than those realized on the specialty items manufactured by appellant from high-grade Douglas fir logs and, in many instances, are marginal (Dep. 30). As a matter of fact, in some instances the market price of hemlock lumber has been less than the price of hemlock logs sold for Japanese export (R. Tr. 31).

R. L. Dickman, Sr., who did not appear as a witness at the trial but whose testimony is a part of the record in deposition form, stated in response to the question with respect to his opinion on any maximum limitation on volume or amount of timber that should be acquired by appellant, as follows:

> "Well, under those conditions we would naturally pick up all that we could that would be the kind that we could use in our mill. * * * but we would bid on all timber that we can that fits our mill." (Dep. 28).

Donald H. Doud stated in his affidavit (portion ad-

mitted by appellee) "that a sawmill of the same capacity and type of plaintiff's sawmill, if it is to continue operating, should acquire all timber that it can purchase within its means, if such timber can be purchased at a price which would permit it to be profitably logged and manufactured into lumber" (R. 167, 168).

The appellee on page 37 and page 38 of its brief, states "that the opinion of the taxpayer's officers and directors as to the purchase of timber at any price, hardly consists of a plan sufficiently specific and definite to justify the retention of the 1959 earnings." On this point we would direct the Court's attention to pages 37 and 38 of appellant's brief which enumerates the purchases of privately owned timber and state timber purchased on a non-scale lump sum cash basis for amounts as high as $1,175,645.00. We would specifically direct the Court's attention to the bid made on June 8, 1959, by appellant on a tract of state timber known as "Sale No. 970" on a non-scale cash lump sum basis in which its cash bid of $510,000.00 was rejected and the timber sold to one of appellant's competitors on a high bid of $697,700.00 (Ex. 2, p. 5). From an examination of this rejected bid it will be noted that the total volume of timber covered by the sale was 14,122,000 feet B.M., of which 8,942,000 feet B.M. consisted of Douglas fir which would have been suitable for the specialty production at appellant's mill. With respect to the statement of appellee on page 35 of its brief, "the appellant's holdings of logs and timber at the end of 1959 were in

excess of a one year's capacity for production of timber," reference should be made to appellee's Exhibit C which is entitled "Schedule of Investment Balance for Timber" (including road construction costs) and covers that period from December 31, 1959 to December 31, 1963. A breakdown of the timber inventory as of December 31, 1959, as shown by Exhibit C, is as follows:

Name of Timber Site	*Investment Balance at 12/31/59*
Jefferson County	$ 36,277.90
Denny Claims	35,000.00
Fernandez	468,305.00
Mt. Craig	39,259.37
Mowich Lake Road No. 2	36,000.00
West Tacoma Newsprint	6,333.34
Simpson Co.	48,410.09
Enumclaw (Greenwater)	77,060.02
Berry Creek No. 3	12,000.00

Unfortunately, the foregoing itemized statement of timber inventory was not explained at the trial. However, the appellee has admitted that the Fernandez item of $468,305.00 should be eliminated since no timber was included in this investment. The Mowich Lake Road #2 undoubtedly applied to road costs on timber previously purchased and does not necesarily show timber reserves. The item designated Enumclaw (Greenwater) refers to State Sale No. 966 in which appellant purchased timber for the total cash sum of $531,002.00 in 1958. There is no information in the exhibit which would indicate whether this particular item included remaining timber or the balance of road and other costs of production. Exhibit C further reveals that at the end of 1958

the dollar timber inventory, exclusive of the Greenwater tract, was limited to the sum of $67,459.81, only a portion of which constituted Douglas fir.

With respect to the log inventory at the end of 1959, Exhibit 4 shows a total log volume of 4,559,760 feet B.M. There is no evidence as to what portion of this log inventory constituted hemlock and related species and what portion constituted Douglas fir suitable for appellant's mill. Mr. R. L. Dickman, Sr., testified on deposition that Douglas fir peelers and high-grade fir sawlogs suitable for appellant's operation could not be purchased on the open market (Dep. 29, 30). William L. Burgess who is a Forester for the Internal Revenue Service and who testified as an expert on behalf of the appellee, stated that logs were difficult to buy even prior to 1956 (R. Tr. 226). In conclusion on this problem, we again refer to the language in *John P. Scripps Newspaper, supra,* and *Bremerton Sun Publishing Co., supra,* which is quoted in the footnote at the bottom of page 15 of this brief, in which it is stated that a newspaper in no way resembles a fungible commodity and a prospective customer cannot merely place an order or draw plans as for a piece of machinery or additional construction, but can do no more than actively search for opportunities for acquisition. The same principle holds true with respect to the availability of logs and timber suitable for appellant's mill which can be obtained in the area in which it is located. We also would refer to the recent Tax Court decision in *Bardahl Manufacturing Co.,* (Filed

7/23/65), T. C. Memo 1965-200, where it was held that an accumulation of earnings for the acquirement and stockpiling of an ingredient of its gasoline additive which was scarce or unobtainable due to an emergency, was a reasonable business need.

IV.

1959 Earnings Properly Accumulated for Retirement of Stock Under Section 303

On this phase of the matter, the appellant would again direct the Court's attention to the lack of cash or liquid assets owned by the principal stockholders of appellant, namely, R. L. Dickman, Sr. and the decedent, Lydia L. Dickman, with which to pay federal estate and state inheritance taxes and the costs and expenses of administration. As pointed out in appellant's opening brief, the total appraised valuation of the community estate of R. L. Dickman, Sr. and the decedent in round figures totalled the sum of $1,594,000. Of this amount, $1,400,000 covered the appraised value of the 4,000 shares of stock of appellant corporation. The balance of the estate assets, having a total appraised valuation in the approximate sum of $194,000.00 consisted of a dwelling house, furniture and art objects situated in the dwelling house, together with certain miscellaneous shares of stock, a portion of which is unlisted, with a total appraised valuation of $70,000.00 (Ex. 11).

In response to the arguments of appellant contained on page 54 of its brief with respect to the dire results which would follow if "a fund could be established to pay the estate taxes of each of the stockholders of the

corporation through a future stock redemption," we would direct the Court's attention to those provisions of Section 303 which limit the retirement of stock for the payment of taxes and costs of administration to those situations where the stock in question constitutes either 50% of the decedent's gross estate, or 35% of the decedent's net estate.

On this whole problem we would refer the Court to the article entitled "Stock Redemption and the Accumulated Earnings Tax" by Professor David H. Herwitz, which is set forth in Volume 74, No. 5 of the Harvard Law Review dated March 9, 1961.

As noted by Professor Herwitz, the "*Mountain State* case 284 F.2d 757 (4th Cir. 1960) appears to have placed its stamp of approval upon the business-purpose analysis of redemption transactions under the accumulated earnings tax." 74 Harv. L. Rev. 866, 918 (1961). The Fourth Circuit Court of Appeals found persuasive the reasoning of *Emeloid Co. v. Commissioner,* (C.A. 3, 1951) 189 F.2d 230 where the Court there held that a corporate business purpose was served by corporate disbursements to pay insurance premiums to provide a fund with which to purchase stock from the estate of a deceased shareholder pursuant to a stock restriction agreement.

See, also, *Fred F. Fisher,* 6 CCH Tax Ct. Memo 520 (1947), where redemption of stock from taxpayer's sister in order to restore harmony constituted a business pur-

pose so as not to be a constructive dividend, c.f. *Gazette Publishing Co. v. Self*, 103 F. Supp. 779 (E.D.Ark. 1952), and Mertens, Law of Federal Income Taxation § 39.35.

V.

Appellant's Evidence Overcame Presumption of Prescribed Purpose

On page 17 of its brief the appellee states that appellant "makes no independent contention that it proved by a preponderance of the evidence that such accumulations—reasonable or otherwise—were not for the purpose of avoiding income tax on it shareholders. On page 20 appellee sets forth as an applicable legal principle that the appellant must not only show under objective standards that the earnings retained were for the reasonable needs of its business, but also carry the burden of proving its actual intent. Section 533(a) of the Code provides in effect that proof of accumulations beyond the reasonable business needs of any corporation is determinative of the purpose "unless the corporation by the preponderance of the evidence shall prove to the contrary."

Paragraph II of the Statement of Points to be relied upon by appellant, which was filed by appellant with the Clerk of the Circuit Court of Appeals in compliance with the Ninth Circuit Rules, reads as follows:

> "That the District Court erred in finding and concluding that the appellant had for its purpose accumulated earnings and profits in the avoidance of income tax on its shareholders."

In its opening brief under the subtitle "Questions Presented," it was stated that one of the questions raised was whether "earnings and surplus had been accumulated for the purpose of avoiding surtax upon the shareholders" of appellant. Appellee relies principally on the three following grounds in arguing that the appellant has not overcome the presumption of the prescibed purpose. First, if the sum of $129,000.00 had been distributed as dividends in 1959, there would have been an increased surtax liability on the shareholders of $87,000.00. Second, the amounts advanced to or for the benefit of the Dickmans at the end of the years 1958 through 1963, as shown on page 12 of appellee's brief, tends to show the prescribed intent; and third, it is urged that the accumulation for the retirement of stock under Section 303 was personal to the shareholders and served no corporate purpose.

In examining the other side of the coin from the appellant's standpoint, the following matters show a lack of intent and constitute evidence overcoming the presumption of the prescribed purpose. First, the noninterest bearing loans to the Dickman family at the end of 1959 were limited to the sum of $9,192.00 which is minimal in view of the large accumulations of surplus and earnings. Second, there were no investments at any time in unrelated businesses. Third, there was no intent to liquidate the corporation as shown by the testimony of R. L. Dickman, Sr. (Dep. 42) which is borne out by the admitted evidence of the investments made in 1960 and

1961 as planned in 1959, covering plant modernization and improvements. Fourth, the appellant's income tax returns were audited each year from 1951 through 1963, and although the ratio of current assets to current liabilities in 1956 and 1957 exceeded the 1959 ratio of 9 to 1, the accumulated earnings tax had never been assessed against appellant. In 1956 the current assets of $1,376,143.00 bore a ratio to the current liabilities of $62,449.00 in excess of 22 to 1. In 1957 the current assets of $1,598,332.37 had a ratio to current liabilities of $33,239.00 in excess of 48 to 1 (R. Tr. 206-211; Ex. 8). It will be further noted from Exhibit 8 that even in the year 1955 with current assets of $1,568,349.00 and current liabilities of $215,698.00, that the ratio of current assets to current liabilities was 7.63 to 1. The Fernandez transaction did not occur until the latter part of 1956 and the resultant loss was not fully known until after the judgment was entered against Fernandez late in 1958. With the foregoing experience from the previous audits which had not resulted in accumulated earnings tax assessments, and with the knowledge of the decision in the *Defiance Lumber Co.*, T. C. Memo Op. Dkt. 84067 (1953), which has been fully discussed in appellant's opening brief, the officers were justified and were honest in their belief that they could accumulate earnings of appellant for the reasonable needs of the business, including the purchase of logs and timber suitable for appellant's mill.

The accumulation of earnings in 1959 was for the

avowed purpose as testified to by appellant's officers (Dep. 39-40; R. Tr. 70, 71) of meeting the reasonably anticipated needs of appellant's business, consisting of hazards of the business, working capital required for the purchase of logs and timber suitable for appellant's mill which could be manufactured into lumber at a profit, the cost of modernization and improvements of mill, and amounts required for retirement of stock under Section 303.

In *Bremerton Sun Publishing, supra,* the Tax Court held that even though there was an accumulation of earnings beyond the reasonable needs of the business, there was no wrongful purpose—namely, an intent to avoid a dividend tax to the shareholders. This lack of intent was based largely on the showing of a history of substantial dividends, no loans to shareholders, and no investments in unrelated businesses. The years involved were 1958 and 1959. In 1958 the taxpayer's current assets amounted to the sum of $639,064.86, and its current liabilities amounted to $165,788.68. In 1959 its current assets amounted to the sum of $594,741.40, and its current liabilities $153,897.09. The Tax Court's ruling that the corporation was not availed of in the avoidance of income tax on the shareholders was grounded on the conservative fiscal policy of the newspaper's directors. Language from the decision is quoted in the footnote.[6]

6. "These factors are strong indications that the accumulations were not for the proscribed purpose, Section 1.533-1(a)(2), Income Tax Regs. Furthermore, there is no doubt that a good history of dividends, the absence of loans to the sole shareholder, the absence of investments in unrelated businesses, and the paying of a large salary to the sole shareholder indicate that the accumulation of earnings and profits was

CONCLUSION

In conclusion, it is urged that the entire record should be reviewed, and that all reasons relied on by appellant for the 1959 accumulation of earnings should be considered collectively and not piecemeal and separately, or on the theory of "divide and conquer," the obvious strategy adopted by appellee in its brief, and the trial court's decision should be reversed because it is clearly erroneous.

In the alternative it is further urged that if this Court on the entire evidence is left with a definite and firm conviction that a mistake has not been committed, and that the decision of the District Court should not be reversed and judgment entered in favor of appellant, then the case should be remanded to the District Court with instructions to make additional and specific findings on all admitted and undisputed evidence in compliance with Rule 52(a) or in the third alternative, that the appellant be granted a new trial.

Respectfully submitted,

OWEN P. HUGHES
NEAL, BONNEVILLE & HUGHES
Attorneys for Appellant,
Dickman Lumber Company

for legitimate business needs. *James M. Pierce Corporation, supra; Gazette Pub. Co. v. Self, supra.* We point this out because it is apparent to us that although the directors of petitioner did accumulate too much surplus, they did so thinking it was necessary for the business needs and not because of any desire to avoid the surtax on its sole shareholder. It must be remembered that the gist of the statutory violation is the intent to use the corporation to avoid surtax on its shareholder and not whether the decision to accumulate the income was wisely made. *KOMA, Inc. v. Commissioner,* 189 F.2d 390, 396 (40 AFTR 712) (C.A. 10, 1951) affirming a Memorandum Opinion of this Court." (44 P.H.-T.C. 421)

CERTIFICATE OF COMPLIANCE

I certify that, in connection with the preparation of this reply brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

OWEN P. HUGHES
Attorney for Appellant

In the United States Court of Appeals for the Ninth Circuit

HANFORD ATOMIC METAL TRADES COUNCIL, AFL-CIO, and C. L .WILLIAMS,
Appellants,

vs.

GENERAL ELECTRIC COMPANY,
a corporation,
Appellee.

NO. 19939

APPEAL FROM THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WASHINGTON

PETITION FOR REHEARING

CRITCHLOW, WILLIAMS & RYALS
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Richland, Washington

FILED
DEC 23 1965
FRANK H. SCHMID, CLERK

In the United States Court of Appeals for the Ninth Circuit

HANFORD ATOMIC METAL TRADES COUNCIL, AFL-CIO, and C. L .WILLIAMS,
Appellants,

vs.

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NO. 19939

APPEAL FROM THE UNITED STATES DISTRICT COURT
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PETITION FOR REHEARING

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Attorneys for Appellants
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Comes now appellant Hanford Atomic Metal Trades Council, by its attorney, David E. Williams, of Critchlow, Williams and Ryals, and respectfully petitions the Court for re-hearing of the decision herein filed November 27, 1965. In support of this petition, appellant represents to the Court:

1. Appellant union and appellee employer were parties to a collective bargaining agreement which provided for lay-offs by seniority; they became involved in a dispute regarding application of such agreement to a situation wherein the employer temporarily laid off a large number of workers, at a time when others, with *less* seniority, were on the job.

2. The dispute aforesaid was formalized by appellant's written grievance, which was lodged with appellee under the terms of the agreement hereinabove referred to. This grievance said:

> "The Council (appellant) herewith files a Step II General Grievance against General Electric Company based on current 'furlough' of bargaining unit employees without proper regard for their seniority. This grievance is filed on behalf of all employees so 'furloughed'. By way of remedy, the Council claims full back pay for all of the employees mentioned; with respect to those employees whose vacations have been rescheduled in lieu of 'furlough' out of seniority, the Council demands restoration of all vacation

time so sacrificed without loss of pay in the premises."

Appellee replied to the grievance by written answer and thereby denied any violation of the agreement aforementioned, whereupon the matter was agreeably referred to binding arbitration.

3. At the outset of the arbitration hearing, appellant carefully supplemented its written grievance with an additional written statement which it served, at that time, upon the appellee and the arbitrators. This supplementary written statement said:

> "... The union (appellant) contends that those people who were forced off the job without pay, pursuant to the Employer's direction, while other employees with less seniority than they were on the job are entitled to back pay ...
>
> "... Reference to the Employer's records will reveal those employees who lost time and pay in the premises while others in their classifications with less seniority than they were working. Such lost pay should be restored. *This is the relief requested by the Union.*"

4. At the arbitration hearing and in the post-hearing briefs, appellee failed to argue or otherwise comment with regard to the relief so requested by the appellant; indeed, appellee remained wholly silent on the question of "damages", and confined its argu-

mentative effort to a denial that the agreement aforesaid had been breached.

5. Thereafter, the arbitration committee duly returned its written award which stated flatly that:

> "AWARD. The submitted grievance is *sustained in its entirety* in accordance with the foregoing Opinion and Findings."

6. Subsequent to such Award, appellant demanded "full back pay" from appellee for those employees "who lost time and pay while others in their classifications with less seniority than they were on the job." Appellee refused this demand and paid back wages only to those laid-off people who, in appellee's unilateral opinion, formed some nine months after the fact, *would have been* allowed to remain on the job *had the contract not been breached.* In other words, appellant, in requesting full back pay, constructed the Award to mean that the *rights of the parties were to be measured by the facts at the time of the layoff;* appellee, on the other hand, constructed the Award to mean that the rights of the parties could be measured "*in retrospect and by hindsight.*"

7. The District Court found, in effect, that the original Award did not make it clear whether the rights of the parties were to be measured by the facts

in existence at the time of the layoff, as appellant contended, or "in retrospect and by hindsight," as appellee contended. The District Court remanded the Award to the arbitrators who, in a second Award, sustained the appellee's construction of the first Award and judgment was then entered by the District Court confirming the second Award. This appeal ensued, appellant contending that the original Award was enforceable in accordance with appellant's construction thereof. This Court ruled for appellee on November 27, 1965.

8. It is plain that the sole issue before the Court is whether or not the original award unequivocally provided that the rights of the parties thereunder were to be measured by the undeniable facts *at the time of layoff*. If so, appellants' demand of full back pay from appellee for all those employees, "who lost time and pay while others . . with less seniority were working", is undeniably well taken. This is so for the reason that appellee's construction of original Award and payments made in accordance therewith necessarily required *retrospective* calculations based on a most liberal application of speculative *hindsight*.

9. It is therefore most important, we submit, that careful attention be accorded the following language

appearing in the arbitrators' written Opinion which accompanied the first and original Award:

> ". . The evidence in the record is uncontradicted that *at the time the layoff was made* on April 8, 1962, it was for an indefinite period. It is only *in retrospect* and *by hindsight* that it is determined that the layoff was for a period of one week. *The parties' rights are to be measured by the facts at the time of layoff.* And given this fact and condition, it follows from the section's negotiated language that *at the time of these layoffs* certain rights accorded by the section arose in favor of the senior employees, namely the right to be laid off *only* by seniority." (Page 23, Ex. I-9)

10. It seems to us that the foregoing quotation from the original Opinion and Award pointedly forecloses any ambiguity relative to the right of senior men to receive back pay if they were, *in fact*, off the job while junior men were working. In the language of such Opinion, their "*rights are to be measured by the facts at the time of layoff.*" That their rights were *not* so measured, is completely beyond argument. Appellee does not deny that junior men were, *in fact*, on the job and working at a time when senior men, from whom it withheld pay, were, *in fact*, laid off.

11. By reason of the foregoing, appellant respectfully requests rehearing in this appeal.

Respectfully submitted,

David E. Williams, of
CRITCHLOW, WILLIAMS & RYALS
Attorneys for Appellants

CERTIFICATE OF COUNSEL

The undersigned certifies that he has examined the pertinent provisions of the Rules of this Court, that in his opinion this Petition for Rehearing complies with the Rules and that it is well founded in law and is not for the purpose of delay.

David E. Williams

NO. 19963

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

1700 OCEAN AVENUE CORPORATION,
a California corporation, et al,

Appellant,

vs.

GBR ASSOCIATES, a foreign corporation,

Appellee.

On Appeal from the United States District Court for the

Southern District of California, Central Division

PETITION FOR REHEARING

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UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

NO. 19963

1700 OCEAN AVENUE CORPORATION, a California corporation,

Appellant,

vs.

GBR ASSOCIATES, a foreign corporation,

Appellee.

PETITION FOR REHEARING

To the Honorable Richard H. Chambers, Chief Judge, Stanley N. Barnes, Circuit Judge, and Ben G. Duniway, Circuit Judge:

Appellant, 1700 Ocean Avenue, hereby petitions for a rehearing to reconsider the judgment entered December 29, 1965, on the following grounds:

1. Appellee's brief quotes, in part and out of context, a significant paragraph of the purchase agreement of June 20, 1959. From this, the impression given is that Mugleston was acting on behalf of appellant in promising to build additional units. But, when read in full (R. 92), it is clear the obligation was that of Mugleston alone. In its opinion this court concedes Mugleston agreed to build the additional units, but goes on to say it is clear that GBR Associates were not volunteers. This is true as to Mugleston, but not as to appellant.

This court states it knows of no reason why appellant should not pay reasonable value of appellee's services, and, parenthetically, that Mugle-

ston, who made the architectural services contract, had lost control of appellant corporation. This parenthetical expression sets a dangerous precedent. No case goes as far as this court in saying that if one requests another to render services, and thus takes on a personal obligation to pay for those services, which may have some incidental value to a third party, then the third party will be required to pay for the services if the first party cannot pay his own obligations. Further, Mugleston could not have requested appellee's services and bound the appellant corporation, since a Receiver had full charge of the conduct of the appellant's business.

2. The full order of the Bankruptcy Court appointing the Receiver (Record Exhibit 2) was clearly that the receiver, and he alone,* was authorized to conduct the business of the appellant. Under bankruptcy law, once a receiver has been appointed, there cannot be a debtor in possession which the officers of the debtor corporation would have been if no receiver had been appointed. Bankruptcy Act, Sec. 342. Here, it is admitted the bankruptcy court acting within its powers appointed a receiver, not a debtor in possession. The result must be that, the receiver having and exercising all powers of the corporation and being duly appointed by the court having jurisdiction, the acts of any others, including the officers of the debtor corporation, while the receiver is in power, must be of no effect.

3. In its opinion this court states it is conceded that Mugleston "was everywhere helping the receiver run the corporation". This is not conceded. Not only did Mugleston not help the Receiver, he never helped to run the corporation - having expressly contracted with a Management firm of Cirod, Inc. to run the corporation - which it did until the receiver was appointed. This Court's attention is specifically called to Proposed Modi-

fied Arrangement and Petition for Leave to File the Same (Record Exhibit 4, page 5, lines 14-16): "Debtor has reaffirmed its employment of Cirod, Inc. to operate and manage the Surfrider Inn, and Cirod, Inc. has reaffirmed its acceptance of such employment." Clearly, Cirod, and not Mugleston, managed the corporation.

4. Order of Confirmation of Modified Arrangement (Record Exhibit 5) states all debts incurred after filing of the bankruptcy petition and prior to confirmation of the arrangement, were to be paid by the receiver; thereafter all creditors, such as this appellee, were restrained from proceeding. This court has said: "The officers and directors had not been enjoined from doing such things." We think they were. However, clearly, the creditors were enjoined and restrained from coming at appellant. In the reasonable course of American business, the plain language of Court Orders is that upon which businessmen make investment and conduct their affairs. It is unfair to permit these foreigners to contract with one another in a foreign country, while an American corporation's affairs are in the hands of its receiver and, thereafter, to permit these foreigners to take money from Americans.

5. There are interlocking non-sequiturs in this case:

(a) This court says the appellant knew quantum meruit lurked, since one of the legal questions listed in the pretrial order was: '(H) Whether plaintiff is entitled to the reasonable value of its services in the event said agreement is held to have no legal effect.' True, quantum meruit lurked, but only in the event said agreement is held to have no legal effect. In the entire transcript and all of the exhibits there is no finding by the trial court that the agreement was held to have no legal effect. On

page 2 at line 14 of its findings (R. 102) it says: "On October 31, 1960, Mugleston, on behalf of defendant corporation, executed a written agreement with plaintiff whereby certain architectural services were to be rendered to defendant corporation by plaintiff to be used in construction of a 45-unit addition to defendant's Surf Rider Inn Motel." Having thus found there was an agreement (not that the agreement was held to have no legal effect), the trial court, contrary to its own pretrial order, went on to grant a remedy based upon quantum meruit for reasonable value of services not a remedy called for by the contract.

(b) The trial court's finding of fact is in direct conflict with its conclusions of law and judgment. If the finding of fact is, as is shown in this record, an express written contract (R. 102), then the conclusions of law and judgment must be made upon and find support in the written agreement and not, as in this case, upon an implied in law contract. (R. 104-105).

(c) This court has stated, on page 2 of its opinion: "The trial court must have held there were fatal infirmities in the execution of the written contract, . . ." The trial court did not so hold. The record is before this Court, and this statement is not supported in that record. Furthermore, assuming this Court's interpretation of the trial court's finding of fact is correct, then there is a fatal defect in the trial court's conclusions of law and judgment. This is so because the implied in law contract is based upon the written contract; and if the written contract is defective, so must the implied in law contract be fatally defective.

6. A transcript of evidence is necessary where it is contended there is no substantial evidence to support the judgment; not to correct inconsistencies in the findings of fact and conclusions of law, as well as

errors in law. Appellant seeks not re-weighing evidentiary matter, it seeks correction of law and findings.

For all of the foregoing reasons, appellant respectfully requests this Court to grant a rehearing in order that its counsel may clearly show why this case should be remanded to the trial court for a judgment that, if the agreement in question was valid, it should be carried out - even as to arbitration. Or, if the agreement is of no legal effect, and it alone is the basis for finding appellee not to be a volunteer, then quantum meruit must also fail. Or, if the agreement in question is of no legal effect, then there must be a finding of some other request by appellant of appellee to support quantum meruit.

Undersigned counsel certifies that this petition is not interposed for delay, and that in his judgment, it is well-founded.

Dated: January 19, 1966.

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By Volney F. Morin

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*Emphasis ours throughout.

State of California)
)ss.
County of Los Angeles)

I, the undersigned, say: I am and was at all times herein mentioned, a citizen of the United States and employed in the County of Los Angeles, over the age of eighteen years, and not a party to the within action or proceeding; that my business address is 1341 North Cahuenga Boulevard, Los Angeles, California 90028; that on January 19th, 1966 I served three copies of PETITION FOR REHEARING on the appellee in said action or proceeding by depositing three true copies thereof enclosed in a sealed envelope with postage thereon fully paid, in a mailbox regularly maintained by the Government of the United States at Cahuenga Boulevard and Homewood Avenue, in the city of Los Angeles, California, addressed to the attorneys of record for said appellee at the office address of said attorneys, as follows:

Russell, Bebout & Swanger

2412 Wilshire Boulevard

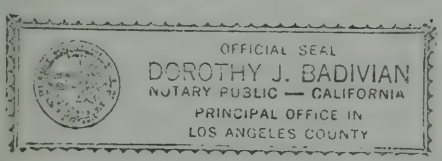
Santa Monica, California

Sarah Scott

Subscribed and sworn to before me

this 19th day of January, 1966.

Dorothy J. Badivian



My Commission Expires Feb. 25 1970

NO. 19964

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

THE DREDGE CORPORATION,

Appellant,

vs.

J. RUSSELL PENNY, et al.,

Appellees.

See also Vol. 3348

APPELLANT'S CLOSING BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEVADA

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FILED
MAR 21 1966
WM. B. LUCK, CLERK

NO. 19964

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

THE DREDGE CORPORATION,

Appellant,

vs.

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APPELLANT'S CLOSING BRIEF

APPEAL FROM
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Cases

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United States v. O'Leary, 63 ID 341 — 3

Ex rel Wilbur v. Krushnic (1930) 280 U.S. 306 — 5

Codes

Administrative Procedure Act — 2, 4

Administrative Procedure Act §1006(c) — 4

Mineral Leasing Act of 1920 — 6

Small Tract Act — 1, 7

30 U. S. C. A. — 2

Constitutions

Constitution of the United States,

Article I — 8

Article II — 9

Article III — 9

Texts

58 Corpus Juris Secundum 143-144 — 5

Rocky Mountain Mineral Law Institute, Vol. 10, p. 467 — 8

NO. 19964

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

THE DREDGE CORPORATION,

Appellant,

vs.

J. RUSSELL PENNY, et al.,

Appellees.

APPELLANT'S CLOSING BRIEF

I

INTRODUCTION

A study of appellee's brief herein shows that it does not meet some of the points made in appellant's opening brief.

For instance the government does not answer the argument of appellant that the failure of the Secretary of the Interior to issue regulations for mining locations was unconstitutional. (See page 17 of opening brief)

2. The government ignores the appellant's discussion beginning on page 25, of its opening brief, that the Secretary has in effect repealed the law as to location of mining claims on minerals reserved under the Small Tract Act, and the mining and

removal of such minerals.

3. No response was made by the government in its brief to appellant's contention in its opening brief on page 27, that since no regulations were issued in connection with the location of mining claims on land classified for small tracts, the rights of the locator are subject only to the mining law, 30 U. S. C. A., cited herein, and therefore the 16 Dredge Placer Mining Claims involved herein were valid when located and are now valid.

4. The action by the Secretary in refusing to issue regulations concerning the location and mining of "hard minerals" is in fact a withdrawal of the land, contrary to the rights granted to the prospector by Congress when the Small Tract Act was enacted.

II

ADMINISTRATIVE PROCEDURE ACT

The decision of the Secretary declaring the sixteen mining claims involved in this litigation to be "void ab initio" is illegal and of no effect because there was no notice of contest and no hearing under the Administrative Procedure Act, or otherwise, therefore the decision is not based on any evidence.

Congress in exercising its power over the public domain, on June 11, 1946, passed the Administrative Procedure Act to protect citizens from administrative abuse.

In a decision by the Secretary of the Interior Seaton, on

September 28, 1956, in the case of the United States v. O'Leary, 63 ID 341, at page 345, Secretary Seaton said:

> "Inasmuch as a mining claim is a property claim, which may not be invalidated without due process of law, hearings on the validity of such claims seem clearly to be within the scope of the Court decisions referred to above, holding that administrative proceedings in which a hearing is necessary in order to satisfy the requirements of due process must comply with the Administrative Procedure Act, even though there is no statute requiring that the matter be determined on the record after opportunity for an agency hearing. In accordance with those decisions, the Department concludes that the hearing requirements of the Administrative Procedure Act are applicable to hearings on the validity of mining claims." (Emphasis added)

The government in its reply brief states on page 17,

> "A public hearing was not required in connection with concluding that appellant's mining claims were null and void."

The government's brief continues on page 17,

> " . . . it would be a pure waste of time, however, to conduct a hearing for the simple purpose of re-determining facts available from the record."

Can the Administrative Procedure Act and former decisions by the Secretary of the Interior regarding that act, be so lightly swept aside? There can be no record where as in this case, there was no hearing and therefore no evidence.

III

BURDEN OF PROOF

It is a fundamental of American jurisprudence that a man is innocent until he is proved guilty. In other words, the prosecution has to prove the man guilty.

Certainly if that is true in criminal matters, it should be true in civil matters. Since the location of a mining claim on lands classified as suitable for small tracts is authorized by Congress, and since a mining claim is presumed to be valid until proved in-valid, the burden of proving such invalidity is upon the Department of the Interior.

It is a fundamental rule of law that violation of the law is not presumed.

It is true that the Department has taken the opposite position in this case, which is contrary to the general rules of mining law, such as that the mining laws must be liberally construed.

Section 1006(c) of the Administrative Procedure Act provides that the burden of proof is on the proponent.

If the Administrative Procedure Act concurred with the

previous rulings of the Department of the Interior that the burden of proof was on the mining claim locator, there would have been no need for this particular provision. It would be surplusage.

That the burden of proof should be on the government is clear, because, a mining claim is presumed to be valid until it is found invalid, and because it is property in the highest sense. This is stated in a decision by the Supreme Court of the United States in Ex rel Wilbur v. Krushnic, 280 U.S. 306, 316, decided in 1930.

There is another rule which supports our position; it is that the law abhors forfeiture. Since Congress has stated that the citizen may locate a mining claim on lands classified as suitable for small tracts, the claim so located is valid until proved invalid. The action by the Department of the Interior in seeking to invalidate the claim, without even a hearing, is an attempted forfeiture. In support of this rule, we cite 58 Corpus Juris Secundum, page 143, and 144.

IV

ARGUMENT

It is obvious that the appellee has taken the position that Congress made a mistake in providing that mining could be conducted on land classified as suitable for small tracts. Therefore the Department felt it was necessary for it to correct this error on the part of Congress by not issuing regulations permitting

mining, and in fact thereby forbidding any mining operations.

That this is appellee's position is shown by the statements contained in its brief, as follows:

Page 8, "absent any regulations to protect the owner of the surface, the land cannot be considered open for mining location."

Page 10, "Instead, Congress left for determination by the Secretary of the Interior, the extent to which reserve minerals would be available for distribution to third parties."

Page 11, "On the other hand, if the small tract remains open for Placer and Lode Mining locations, the small tract purchaser could be completely dispossessed -- and the purpose of the act frustrated."

Page 14, "In essence, then, Congress has left the matter of resolving the conflicts inherent in the separate disposition of land and minerals under the small tract act to the Secretary of the Interior. Under his regulations, the Secretary provides that such minerals may be devloped under the Mineral Leasing Act of 1920, but not otherwise." (Emphasis added)

Page 16, "Only confusion would result from permitting mineral locations with the attendant claim of a right of possession, on land classified for small tract disposition -- ."

In support of its position, the appellee cites the case of Superior Sand and Gravel Mining Co. v. Territory of Alaska, 224 F. 2d 623 (CA 9 1955).

In that case it is shown that Congress has reserved to the

Territory of Alaska, upon survey, sections 16 and 36 of each township for support of the Territorial Schools. Congress further provided that the Territory could lease such school lands for a ten year period. In 1939 such legislation was amended to provide that

> "such land and the minerals therein shall be subject to disposition under the Mining and Mineral Leasing Laws -- upon conditions providing for compensation to any territorial lessee for any resulting damages to crops or improvements on such land."

Such a provision is not contained in the Small Tract Act. It is obvious that the Department of the Interior feels that it must incorporate such a provision into the Small Tract Act by its administration of said Act, contrary to the law as passed by Congress.

The Secretary of the Interior must obey the law as passed by Congress.

The best example of this is cited in Appellant's Opening Brief on page 19. In the case of Jacob A. Harris, 42 LD 611, decided December 13, 1913, on page 614, the Commissioner of the General Land Office states:

> "It is unnecessary to consider so obvious and fundamentally a proposition as that an executive department of the Government has no legislative power, and must leave to Congress and the Courts the rectification of any evil that may flow from its administration of the

law." (Emphasis added)

Proof of the Department's attitude is shown by statements made by H. R. Hochmuth, then Associate Director of the Bureau of Land Management, in a speech he delivered July 17, 1964, at Salt Lake City, before the Rocky Mountain Mineral Law Institute (published in the official volume 10, of the Rocky Mountain Mineral Law Institute beginning at page 467).

Speaking of the mining law, Mr. Hochmuth stated:

" . . . since that date, the law has been subject to repeated and evolutionary change through precedent and administration."

Then the next sentence reads,

"There can be no gain saying that the mining law of 1872 is not administered as it was originally written and intended --- " (Emphasis added)

Again, we quote the following startling statement made by Mr. H. R. Hochmuth in the same speech:

" ... the result being that what we are administering today, is not the mining law, but the rather substantial body of legal and quasi-legal precedents which largely are of our own making --- "

Neither the Department of Interior nor a court may alter or amend a law.

(1) Article I of the Constitution of the United States which creates the Legislative Department, begins with this sentance:

"The legislative power herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and a House of Representatives. . . ."

Article II, which creates the Executive Department, in Section 2, contains this clause:

". . . he shall take care that the laws be faithfully executed, . . ."

Article III creates the Judicial Department, which interprets laws passed by Congress.

(2) It is a well-settled rule of law that agency regulations or decisions may not alter or amend a statute passed by Congress which the agency is administering.

For instance, in Stark v. Wickard (1944), 321 U.S. 288, 309, 64 Sup. Rep. 559, 590, the court said:

"When Congress passes an act empowering administrative agencies to carry out government activities, the power of this agency is circumscribed by the authority granted."

For another decision, which involves another attempt by the Department of the Interior to amend a law, see Burke v. Southern Pacific Railroad Co. (1914), 234 U.S. 669, 697 and 705, 58 LawEd. 1527, 34 Sup. Ct. Rep. 907.

In that case the Interior Department inserted in a patent to the Southern Pacific Railroad Co. a reservation of the minerals. Such reservation was not authorized in the law passed by Congress relating thereto.

This is a very long decision, and the Supreme Court of the United States thoroughly considered the question of the Department of the Interior adding to the provisions of various land laws.

At page 697, the Supreme Court quoted, with approval, the following from a decision by a Secretary of the Interior:

> " . . . The exception contained in the patent went beyond 'giving expression to the intent of the Statute' as construed by the Supreme Court, and added a restriction which is not to be found in the granting Act."

Again, at page 705, the court quoted from one of its earlier decisions:

> " . . . The exemptions of the statute cannot be extended by those whose duty it is to supervise the issuing of the patent."

It is possible that the provision of the law allowing mining on small tract lands was inserted by Congress to protect the Secretary in the event he made a mistake and classified mineral land as being suitable for small tract use.

It is possible that regulations regarding mining in such cases could require the mine owner to compensate the small tract owner to the full extent of the purchase price of his small tract as a condition precedent to mining operations.

But for the Secretary to issue regulations that prevent any mining operation is directly contrary to the provision of the small tract law as passed by Congress, and is an attempt of the Secretary by "executive legislation" to nullify an act of Congress.

CONCLUSION

The question in this case is whether Congress or the Secretary of the Interior is the determining factor in making the law.

Congress passes a law, can the Secretary negate it by (1) failing to act, (2) by issuing a regulation contrary to the rights granted by the act of Congress?

Appellant contends that the Secretary must obey the laws passed by Congress, and any regulations contrary to the intent of Congress are a nullity.

Appellant prays:

(1) That the judgment of the District Court granting Defendants' motion for summary judgment be reversed.

(2) That the District Court be directed to find that the classification orders classifying the lands covered by these Mining Claims as suitable for small tract use are illegal and

void.

(3) That the District Court be directed to find that the decision of the Secretary of the Interior is void, and the 16 Placer Mining Claims involved herein are valid.

Respectfully submitted,

GEORGE W. NILSSON
DEANER, BUTLER & ADAMSON

By GEORGE W. NILSSON

Attorneys for Appellant

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ George W. Nilsson
GEORGE W. NILSSON

NO. 19964

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

THE DREDGE CORPORATION,

Appellant,

vs.

J. RUSSELL PENNY, STATE SUPERVISOR, Bureau of Land Management, et al.,

Appellees.

PETITION FOR REHEARING

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEVADA

GEORGE W. NILSSON
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714 West Olympic Boulevard
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FILED

NO. 19964

IN THE UNITED STATES COURT OF APPEALS

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THE DREDGE CORPORATION,

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NO. 19964

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

THE DREDGE CORPORATION,

Appellant,

vs.

J. RUSSELL PENNY, STATE SUPERVISOR, Bureau of Land Management, et al.,

Appellees.

PETITION FOR REHEARING

Appellant presents this, its petition for rehearing of the above entitled cause, by the Court sitting en banc, and in support thereof respectfully shows the following, which appellant believes are substantial errors of this Court, as shown from its opinion dated May 23, 1966:

I

The principles contended for by the appellant herein are important because:

(a) These principles are important to mining generally as well as to the appellant directly;

(b) The Department of Interior should be compelled to obey the Constitution, leaving legislation to the Congress, (See Pages 6 and 9 of our closing brief) and to administer all laws as written

and intended.

(c) Laws affecting mining should be liberally construed as directed by decisions of the Supreme Court of the United States and other courts.

II

(a) The court erred in deciding that the Secretary of the Interior in issuing his so-called Regulations in the summer of 1938 was merely acting within his discretion. See page 3 of opinion which reads in part:

". . . In our judgment the Regulation was a proper exercise of administrative discretion under the Act. . ."

The Regulation above referred to, first issued in 1938, (see 43 C. R. F. '1954rd' 257. 15 (a)) reads in part as follows:

". . . Any minerals subject to the leasing laws in the lands patented or leased under the terms of the act may be disposed of to any qualified person under applicable laws and regulations in force at the time of such disposal. No provision is made at this time to prospect for, mine, or remove the other kinds of minerals that may be found in such lands; and until rules and regulations have been issued, such reserved deposits will not be subject to prospecting or disposition. "

(b) Nothing in the Small Tracts Act gave the Secretary of the Interior the power or the discretion to differentiate between issuing oil and gas leases covering small tracts and refusing to permit the location of mining claims thereon.

(c) The so-called Regulation, which shuts off the mining of "other kinds of minerals", is not a Regulation, but an attempt to amend the law, because the Secretary did not agree with the provisions of the law passed by the Act of Congress.

"To regulate means to adjust by rule or method or established mode; to direct by rule or restriction; to subject to governing principles of law, but the term does not include the power to prohibit."

The above definition of "Regulate" and "Regulation" has been decided by many courts. Under the limitations of the rules of this court such quotations cannot be given, but we are prepared to furnish them.

III

It is clear that the intention of the Department of the Interior was to prevent the location of mining claims contrary to the provisions of the Small Tracts Act instead of Regulating such mining operations.

This is proved by the address of Hon. H. R. Hochmuth before the Rocky Mountain Mineral Law Institute on July 17, 1964 quoted on page 9 of our closing brief and the statements contained in the brief of the United States in the District Court on behalf of the defendant herein, quoted on page 6 of our closing brief.

Such position taken by the Department of the Interior is therefore, unconstitutional, illegal, contrary to the Small Tracts Act and shows that the Secretary's action in issuing the "Regulation" here under review was arbitrary, capricious and an abuse of any

discretion which the Secretary might have had.

Such attempt to shut off mining of "other kinds of minerals" was an unconstitutional attempt by the Secretary to repeal a portion of the Small Tracts Act.

IV

The Small Tracts Act gave to the Secretary the power to issue regulations. He issued regulations for oil leases to be issued over small tracts, but refused to issue any regulations concerning location of mining claims.

The law was passed in June, 1938. "Regulations" were shortly thereafter issued. Our mining claims were located in 1952; 14 years later.

If the regulations issued in 1938, refusing to issue a regulation concerning location of "other kinds of minerals", was actually the use of discretion, such discretion did not last 14 years. The only discretion the Secretary had was to prevent the location of mining claims until he could apply to the Congress for an amendment of the Small Tracts Act to prevent the location of mining claims.

V

(a) The principles contended for by the appellant herein is important to the Mining Industry of the State of Nevada because mining is by statute designated to be important to the State and a public use. 516.010 et seq., Nevada Revised Statute.

(b) The result of this case is also important to the City of Las Vegas, Clark County, Nevada, because the sand and gravel on these claims are located close to this city and therefore important

to it. (See Record.)

VI

In our opinion the decision in the case of Superior Sand and Gravel Mining Company v. Territory of Alaska, cited on page 3 of this Court's decision, is not applicable here because the lands in Alaska were school lands. Naturally, mining would be incompatible with the use of lands for schools.

In our case the Small Tracts are private, there is no more damage to the land by mining "other kinds of minerals" than there is for drilling for oil. Therefore, the Secretary, in allowing oil and gas leases, but prohibiting location of mining claims, was doing something which the statute does not authorize him to do.

In addition, as pointed out above, if the law was injurious to the Small Tracts owner, the amendment to the law had to be passed by the Congress and not by the Secretary of the Interior.

WHEREFORE, the appellant respectfully requests that this Court grant its petition for rehearing.

Dated July 15, 1966.

Respectfully submitted,

GEORGE W. NILSSON

DEANER, BUTLER & ADAMSON

By: GEORGE W. NILSSON

Attorneys for Appellant

CERTIFICATE

I have been practicing law for more than fifty years, during all of which time I have handled mining law. I have been admitted to this court since on or about October 17, 1923.

I certify that in my judgment the foregoing Petition For Rehearing is well founded and that it is not interposed for delay, but to secure justice for the mining claimant and proper administration of laws affecting mining.

/s/ George W. Nilsson

GEORGE W. NILSSON

No. 19,967

In the

United States Court of Appeals

For the Ninth Circuit

BANKERS LIFE AND CASUALTY COMPANY,
a corporation,
Appellant,

vs.

ARIZONA PUBLIC SERVICE COMPANY,
a corporation,
Appellee.

Petition for Rehearing

FILED

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No. 19967

In the

United States Court of Appeals

For the Ninth Circuit

BANKERS LIFE AND CASUALTY COMPANY,
a corporation,
Appellant,

vs.

ARIZONA PUBLIC SERVICE COMPANY,
a corporation,
Appellee.

Petition for Rehearing

To the Honorable
Charles M. Merrill, *Circuit Judge*
M. Oliver Koelsch, *Circuit Judge,* and
James R. Browning, *Circuit Judge*

Appellant, BANKERS LIFE AND CASUALTY COMPANY, hereby petitions for a rehearing to consider the judgment entered in this action on August 15, 1966, on the following grounds:

1. This is simply not a case where estoppel or waiver are available to force appellant to pay a claim caused by an excluded risk. The general and majority rule is that neither estoppel nor waiver is available to an insured, to bring within the coverage of an insurance policy, risks that are not covered or that are specifically excluded. The rationale for the rule is that to apply these doctrines to an excluded risk would be to make a new con-

tract for the parties and to force the insurer to protect against a risk for which no premium was charged. Many cases following this rule are cited in 1 ALR3d at page 1147. The following is a quote from 1 ALR3d 1144:

> "While waiver and estoppel have been held applicable to nearly every area in which an insurer may deny liability, the courts of most jurisdictions agree that these concepts are not available to broaden the coverage of a policy so as to protect the insured against risks not included therein or expressly excluded therefrom. . . ."

A corollary to this rule is that estoppel or waiver are available to an insured to prevent a forfeiture of all his rights under a policy of insurance. The rationale for this rule is that an insurer will not be permitted to issue a policy while knowing facts about the insured or the risk that would render the policy void or worthless. The question raised by the instant matter is, then: does the reliance by the appellant on the exclusion clause of its policy result in a forfeiture of all appellee's rights under the policy so that waiver or estoppel is available to appellee or does such reliance merely prevent the appellee from recovering on a risk that is specifically excluded from the policy?

The two cases cited by the appellee in support of its estoppel theory and the one case cited by the Court in its opinion are forfeiture cases where estoppel was found to exist in order to prevent a complete forfeiture of the insured's rights. They do not, therefore, apply to the facts of the instant case. In *Great Northern Life Ins. Co. v. Cole,* 207 Okla. 171, 248 P.2d 608 (1952), the policy excluded from coverage anyone who was employed as, among other things, an "automobile machinist." When the policy was issued, the insurer knew that the insured was so employed and he continued to be so employed until his death. To have given effect to this exclusion would have allowed the insurer to charge premiums for a worthless policy. In *Schwindermann v. Greater Eastern Casualty Co.,* 38 N.D. 584, 165 N.W. 982 (1917), the insured was employed as a boilermaker for a railroad. The insurer knew this. The policy excluded boilermakers from coverage. Since

the insured was a member of a class of persons totally excluded from coverage and since the insurer knew this when the policy was issued, the Court held that the exclusion relied upon had been waived by the insurer.

In its opinion, this Court has cited *Golden Gate Motor Transport Co. v. Great American Indemnity Co.*, 6 C.2d 439, 58 P.2d 374 (1936). Here again, the effect of allowing the insurer to rely on the policy provision it cited would be to totally deprive the insured of any protection under its policy. Estoppel was used to prevent a forfeiture.

It is respectfully urged that the instant case is not one where a reliance on the aviation exlcusion clause in appellant's policy would render the policy sued upon void. As has been pointed out in appellant's briefs filed herein, the appellee had substantial rights under the policy it received from appellant. Mr. Petris was covered for injury or death caused by an almost limitless number of incidents. There were a few clear restrictions on appellant's right to recover under the policy, but these certainly did not void the policy or make it worthless. Since no forfeiture of appellee's rights under the policy will result from an enforcement of the aviation exclusion clause, the doctrines of waiver or estoppel are not available to the appellee under the majority rule referred to above.

It is still felt that the case appellant has cited, *Hobbs v. Franklin Life Ins. Co.*, (5th Cir. 1958), 253 F.2d 591, is closer to the facts of the instant matter than any case cited by the appellee or the Court. There is no point in re-reviewing the *Hobbs* case here. It is enough to say that the insured in *Hobbs* was not excluded from all coverage because of his occupation as a pilot as in the cases cited by the appellee.

Appellee has made much of the fact that Mr. Petris was listed as an insured person on appellant's policy and the fact that appellant's agent supposedly said Mr. Petris was covered under the policy. As has been pointed out, Mr. Petris was covered, subject, of course, to the exclusions in the policy. No complaint about the policy was ever made by the appellant, although it had it in its

possession for over a year before Mr. Petris' accident, nor has there been any attempt by it to reform the policy. See *Birmingham Fire Ins. Co. of Pennsylvania v. Sharrow,* (S.D. Fla. 1965), 249 F. Supp. 429, where the Court made the following statement regarding representations as to coverage:

> "Such representation is not construed by the Court to constitute a misrepresentation inasmuch as Peter would be covered by the policy, subject to the exclusions therein, while driving an automobile not owned by his parents. Even if the agency had extended coverage of the policy by oral representation, such representation would not constitute waiver or estoppel. The doctrine of waiver and estoppel is not available to an insured when its effect would be to provide coverage where such coverage is expressly excepted or excluded from the terms of the policy." (Citing authorities.)

This Court has recognized the rule relied upon herein. See *Van Meter v. Franklin Fire Ins. Co.,* (9th Cir. 1947), 164 F.2d 325.

2. The Federal Court cases relied upon by appellee on the question of the construction of appellant's policy exclusion have been reversed. See *United Services Life Insurance Company v. Delaney,* (5th Cir. 1966), 358 F.2d 175; *St. Paul Mercury Insurance Company v. Price,* (5th Cir. 1966), 359 F.2d 74; and *Paul Revere Life Ins. Co. v. First National Bank in Dallas,* (5th Cir. 1966), 359 F.2d 641.

Respectfully submitted,

JENNINGS, STROUSS, SALMON & TRASK

By JOHN S. HOBBS

111 West Monroe Street
Phoenix, Arizona 85003
Attorneys for Appellant

Undersigned counsel certifies that this petition is not interposed for delay and that in his judgment it is well founded.

Dated: October 14, 1966

JOHN S. HOBBS

No. 19975

IN THE

United States Court of Appeals For the Ninth Circuit

FRANK M. GRAVEN,
Plaintiff,

v.

ARTHUR PASA,
Defendant,

Appellants,

USIBELLI COAL MINES, INC., *Intervenor,*
GENERAL ACCIDENT FIRE AND LIFE ASSURANCE CORPORATION, LTD., a corporation, and POTOMAC INSURANCE COMPANY, a corporation, d/b/a GENERAL ACCIDENT GROUP,
Third Party Defendants,
Appellees.

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE CHARLES L. POWELL, *Judge*

REPLY BRIEF OF APPELLANTS

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IN THE

United States Court of Appeals For the Ninth Circuit

FRANK M. GRAVEN, Plaintiff, v. ARTHUR PASA, Defendant, *Appellants,* USIBELLI COAL MINES, INC., *Intervenor,* GENERAL ACCIDENT FIRE AND LIFE ASSURANCE CORPORATION, LTD., a corporation, and POTOMAC INSURANCE COMPANY, a corporation, d/b/a GENERAL ACCIDENT GROUP, Third Party Defendants, *Appellees.*	No. 19975

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE CHARLES L. POWELL, *Judge*

REPLY BRIEF OF APPELLANTS

COUNTER-STATEMENT OF THE CASE

The appellees make certain statements in their counter-statement of the case which cannot stand unchallenged, since they are not accurate, and since they may be of considerable importance. Thus we find at page 3 of the appellees' brief: "Fred Savage, the general superintendent, was the one who was personally present and in direct charge, supervision and control of the mining opera-

tions of the company, including its underground operation —not the defendant Pasa." This is just not true. On pages 54 and 55 R.P., we find the following:

"Q. But as foreman you were the only one over at Suntrana?

"A. Yes.

"Q. Physically over there continuously?

"A. Yes.

"Q. You were located over there?

"A. Yes.

"Q. And when Savage was in charge at Usibelli of the strip pit you would be in charge there?

"A. Yes, that's right.

"Q. And you stated that you saw Savage pretty often?

"A. Oh, just about every day.

"Q. Just about every day?

"A. Yes.

"Q. Then, how often would he come over; every day?

"A. Well, he ate supper there every day and he might check the camp once every day and it all depended on the work, and he was down there and he was usually down there every night.

"Q. Let's see if I understand you. He would eat supper with you every day.

"A. Well, not with me but at the camp.

"Q. And you would tell him what would be going on?

"A. Well, it was normally routine that we would talk and I would tell him what was going on.

"Q. And how long would he stay?

"A. Well, he would eat supper and listen to what was going on.

"Q. About one hour or so?

"A. One-half hour.

"Q. And that would be a regular thing every day?

"A. Yes, unless he missed his supper.

"Q. And you say, then, that he also inspected the mine about once a week?

"A. Yes, he would come around about once a week.

"Q. And he would actually go into the mine and into each of the rooms and inspect them?

"A. Yes.

"Q. And how long would that inspection last?

"A. I don't know.

"Q. Could you give me an approximation? Would it be eight hours or two hours or one hour?

"A. Well, I'd say from one hour to two hours."

Likewise, at page 65, R.P., we find the following:

"Q. Now, when he came down to see your operation and inspect it did he give specific orders about it and specific directions about what should be done and what should not be done?

"A. Well, not too much. I think after a person mines about thirty some odd years you have a very good knowledge of what is going on, both mining and mechanically, both.

"Q. During this period of time were you ever relieved from your duties?

"A. No. Not until that—after where I went into the shop.

"Q. Well, yes, but I am talking about before or at the time of the accident?

"A. No. No."

These portions of the record, along with the record cited previously in appellants' brief, at pages 14 through 17, clearly indicate that Savage was not the one who was personally present and in direct charge, supervision, and control of the underground operation. The record is clear that it was Pasa who was in control and that the only supervision Savage had was as the general manager of the company.

Later, on page 3 of the appellees' brief, it is stated that "Pasa was but one of the foremen at the operation, and that other foremen were employed *there*, . . ." (emphasis ours).

The record is clear that the other foremen were not employed at the Suntrana site and had no equivalent duties to Pasa and that Pasa was the person in charge of the Suntrana site (R.P. pp. 83-84, and other portions of the record).

The statement is made by appellees' counsel that Pasa did not hire or *fire* the miners who worked there. On page 66, R.P., it is clear that on occasion he did fire certain people.

Finally, at page 7 of the appellees' brief, appellees' counsel states that,

> "Defendant Pasa had no managerial responsibility for the affairs of the coal mining company generally. . ."

But it is quite clear from the record that he did have managerial responsibility for the affairs of the Suntrana site generally, and this is pointed out in the excerpts cited in the appellants' opening brief, and at pages 63 through 70, and page 85, R.P.

ARGUMENT IN REPLY

The appellees cite three cases arising out of Louisiana in support of their position. All three are distinguishable, and in any event merely relate only the position of one jurisdiction. The cases of *Bruce v. Travelers Insurance Co.*, 266 F.2d 780 (1959), 5th Cir., and *Employers Liability Insurance Corp.*, 150 So.2d 595 (La. 1963) are cases in which foremen were held not to be executive officers. However, the evidence therein indicated that these foremen did not have the responsibilities and duties of Pasa and further that they were not in charge of an entire real estate complex, where people worked and lived, and where there was an entire mine and community which was separate from the other operations of the company. Furthermore these two cases make no holding, nor do they in any way indicate any dictum, as to whether or not such a person is a "proprietor with respect to real estate management."

In the one cited case which does attempt to make a decision with respect as to "proprietorship with respect to real estate management," *Golman v. Fidelity & Casualty Co. of New York, Inc.*, 146 So.2d 461 (La. 1962), the Louisiana court held that a boy who collected the greens

fees and rented the clubs at a golf course was not a proprietor with respect to real estate management. This decision is correct, but it is so readily distinguishable as to require no further comment. This boy was nowhere near in the position of defendant Pasa nor had he any of the responsibilities or duties of Pasa. That cause cannot be authority for anything involved in the cause before this court.

In any event, the authorities cited by appellees are Louisiana authorities. The appellants have cited what they believe to be applicable authorities from the state of California. In such a circumstance, this court is left with a choice. This court may exercise its unfettered deliberation with respect to determining the course that it will take. It is to be pointed out that California is a Ninth Circuit jurisdiction and Louisiana is not. It is also to be pointed out that, as will be argued subsequently herein, reasonable judgment and policy dictate a decision in favor of the appellants' position — that Pasa should be considered an insured under the terms of the insurance contract here in question.

In their opening brief, the appellants pointed out the settled rules of construction of insurance contracts; that such are to be strictly construed against the company issuing them and in favor of the party claiming coverage. This was such familiar law that appellants did not deem it necessary to cite authority in support thereof. However, the appellees, in their brief, have attempted to restrict this rule of law, and have stated, without any

authority, that the rule is that the insurance contracts are only construed liberally in favor of those who are parties to the contract and who have paid premiums. The appellees made the argument that since appellants cannot qualify as parties to the contract, then they are in no position to urge for liberal construction. The appellees' position is just not the law and never has been the law. In researching this question, appellants' counsel has nowhere been able to find the restrictive phrasing urged by the appellees, and strongly believes there is no authority to support appellees' position. In fact, in a leading Washington case on the construction of insurance contracts, *Doke v. United Pacific Insurance Company,* 15 Wn.2d 536, 131 P.2d 436 (1942), the main question is whether or not the injured person was "in the line of duty" when he was injured. If he were not in the line of duty, then he was not covered; if he was in the line of duty, then he was covered by the insurance contract. In that case the person who was seeking to be covered by the insurance policy was clearly not a party to the contract and had not paid any premium in order to obtain the benefit of the coverage provided. Nevertheless the Supreme Court of Washington held,

> "That being true, the meaning and construction most favorable to the insured must be applied, even though the insurer may have intended another meaning, because the insurer, and not the insured is the author of the instrument. *Kane v. Order of United Commercial Travellers,* 3 Wn.2d 355, P.2d 1036; *Zinn v. Equitable Life Insurance Company,* 6 Wn. 2d 379, 107 P.2d 921."

As was stated, without restriction or limitation, in *Guaranty Trust Co. v. Continental Life Ins. Co.*, 159 Wash. 683, 294 Pac. 585:

> "There is another principle applying to contracts of insurance to the effect that, if they are so drawn as to require interpretation and fairly susceptible of two different conclusions, the one will be adopted most favorable to the insured; and will be liberally construed in favor of the object to be accomplished, and conditions and provisions therein will be strictly construed against the insurer, as they are issued upon printed forms prepared by experts at the instance of the insurer, in the preparation of which the insured has no voice. *Algoe v. Pacific Mutual Life Ins. Co.*, 91 Wash. 324, 157 Pac. 993, *Fenton v. Poston*, 114 Wash. 217, 195 Pac. 31, *Thompson v. Brotherhood of American Yeomen*, 130 Wash. 179, 226 Pac. 498, *Continental Life Ins. Co. v. Wells*, 38 Ga. 99, 142 S.E. 900, *Mathews v. Modern Woodmen of America*, 236 Mo. 326, 139 S.W. 151."

The United States Court of Appeals, in cases arising in Washington, has held similarly. In *Thames & Mersey Marine Insurance Co. v. Pacific Creosoting Co.*, 223 Fed. 561 (1914), it was held that the language of exceptions, warranties and conditions in insurance policies must be clear, and any doubt in the meaning thereof will be construed against the insurer. In *Reserve Life Insurance Co. v. Marr*, 254 F.2d 289, cert. den. 358 U.S. 839, 79 S.Ct. 63, 3 L.Ed.2d 74, it was held that a policy will be liberally construed in favor of the object to be accomplished, and the conditions and provisions thereof will be strictly construed against the insurer.

In 29 Am. Jur., Section 258, page 640, it is held that,

> "The general rule applicable to contracts generally, that a written agreement should, in case of doubt as to the meaning thereof, be interpreted against the party who has drawn it, is very frequently applied to policies of insurance and constitutes an important rule of instruction in such respect, in view of the fact that ordinarily, and in practically all cases, it is the insurer who furnishes or prepares the policies used to embody the insurance contracts."

Later in the section the following is pointed out:

> "For instance, it has been stated that where the provisions of a policy of insurance are reasonably susceptible of two constructions consistent with the object of the obligation, one favorable to the insured and the other favorable to the insurer, the former will be adopted; . . ."

In Section 264 the following is found:

> "The rule is well established that if conditions, exceptions and exemptions from, or limitations of, the liability of an insurer are not expressed plainly and without ambiguity, they will be construed strictly against the insurer. . . . The reason for this rule is that the insurance company selected the phrase to be construed and should have specifically excluded the risk if there was any doubt."

It is thus clear that the rules of construction of insurance contracts are without limitation and should apply in favor of the appellants in this case. The fact is that the language is, if not entirely favorable to the insured, at least unclear, and the construction of the contract should be in favor of the appellants herein.

What is the real purpose of this insurance contract?

Clearly it must be to protect Usibelli Coal Mines, Inc., the corporation, from financial loss arising from the acts and decisions of the persons who have supervisory responsibilities and who are the real and active participants and decision-makers in the conduct of the corporation, and the corporation's holdings in real property. If the insurance contract were to be given a more restricted meaning, then the need for the insurance contract would be greatly minimized, if not negatived. After all, of the named officers in the corporation, only the president, Emil Usibelli, was an active participant in the conduct of the corporation. The vice-president and secretary were merely named persons who had no active participation. Likewise, of the named directors, only Emil Usibelli had any active participation in the corporation.

The nature of the modern corporation is such that directors, stockholders and other officers, with individual exceptions, do not have any active participation in the affairs of the corporation. Thus the insurance contract which attempts protection of the decision-makers in the corporation must reasonably intend to refer to the real and active decision-makers and supervisors and must not be restricted to wives, figureheads and prominent names who happen to hold an office or a share of stock. It appears most reasonable that this court, with a choice to make, both as to the law involved and as to the interpretation of the insurance contract, should look to the real intention of liability insurance in this circumstance and hold that the defendant Pasa was covered by such insurance.

It is certainly clear that Pasa exercised independent judgment, that he was, and this is admitted by all parties, a supervisory employee (see the Answers to Interrogatories and R.P. 59, 60, 66, 68) and that he acted, with respect to the Suntrana site, as an executive officer and proprietor.

Finally the appellants wish to make it clear that they have no argument with the Findings of Fact made by the trial court, and thus the appellees' argument that Rule 52 (a) of the Federal Rules of Civil Procedure requires this court to accept any Findings of Fact of the trial court unless those findings are clearly erroneous is in no way harmful to the appellants' case. Appellants would urge that, accepting the Findings as made, nevertheless the Conclusions of Law and the Judgment are, on the basis of the Findings of Fact and the record, not apt, and are indeed erroneous.

CONCLUSION

For all the reasons set forth herein and in appellants' opening brief, it is respectfully urged that this court should hold as a matter of law that the defendant Pasa was covered by the policy of insurance herein involved on the date in question in his position with Usibelli Coal Mines, Inc.

Respectfully submitted,

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and CLEARY S. CONE
DONALD J. HOROWITZ of Counsel
Attorneys for Appellants

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion the foregoing brief is in full compliance with those rules.

DONALD J. HOROWITZ
Of Counsel for Appellants

No. 19975

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

FRANK M. GRAVEN, *Plaintiff,*

v.

ARTHUR PASA, *Defendant,*

Appellants,

USIBELLI COAL MINES, INC., *Intervenor,*

GENERAL ACCIDENT FIRE and LIFE ASSURANCE CORPORATION, LTD., a corporation, and POTOMAC INSURANCE COMPANY, a corporation, d/b/a GENERAL ACCIDENT GROUP, *Third Party Defendants,*

Appellees.

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE CHARLES L. POWELL, *Judge*

BRIEF OF APPELLEES

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No. 19975

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GENERAL ACCIDENT FIRE and LIFE ASSURANCE CORPORATION, LTD., a corporation, and POTOMAC INSURANCE COMPANY, a corporation, d/b/a GENERAL ACCIDENT GROUP, *Third Party Defendants,*

Appellees.

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE CHARLES L. POWELL, *Judge*

BRIEF OF APPELLEES

COUNTER STATEMENT OF THE CASE

Generally speaking the statement of the case provided by the appellants is satisfactory for the purposes of this appeal, but it contains some statements requiring a brief

counterstatement, and there are some additional facts appearing in the record which should be placed before the court in determining this appeal.

In their brief at page 7, the appellants state that "over this area (underground mining), defendant, Arthur Pasa, had supervision, charge and control." The appellants have not properly interpreted the evidence in this respect. It is quite clear from the record that Usibelli Coal Mines, Inc., an Alaskan corporation, has a coal mining operation located some 110 miles from Fairbanks and 10 miles from Suntrana, Alaska. The company operates an open pit, or coal stripping operation at this point, and two miles away operates its Suntrana underground mining operation. (R. P. 22) At the open pit operation it maintains its company mining offices where the president, Usibelli, had his office, and where desk space was maintained at the time in question for its general manager, Mr. William Waugaman, and its general superintendent of operations, Fred Savage. (R. P. 52-53) The defendant Pasa was an underground mine foreman, principally operating on the nightshift at the underground operation. (R. P. 24, 26-27) General superintendent Savage was in control of and had direct supervision over both the pit and underground operations. (R. P. 25, 83) He visited the underground operation each day, had his meals there in the evening, and talked to Pasa about the progress of the work that was going on at the underground operation each day; he inspected the

underground operation weekly, often being accompanied by Pasa in connection with his inspections, and Pasa consulted with him whenever emergent situations required him to do so. (R. P. 44, 54-56) Thus Fred Savage, the general superintendent, was the one who was personally present and in direct charge, supervision and control of the mining operations of the company, including its underground operation — not the defendant Pasa. (R. P. 25, 44, 54-55, 83)

It further appears from the record that the defendant Pasa was but one of the foremen at the operation, and that other foremen were employed there, equal in rank and pay, and all of them were subject to the supervision of superintendent Savage. (R. P. 31, 83-84) Pasa did not hire or fire the miners who worked there, exercising only disciplinary control over those who had been hired, always subject to control by his superiors. (R. P. 29)

The trial court made the following Findings of Fact:

"1. That on December 6, 1961, defendant Arthur Pasa was an underground foreman, employed by the intervenor Usibelli Coal Mines, Incorporated.

* * * * * *

"4. The defendant Pasa was in specific charge of the underground mining operation and was in specific charge of the operations at the Suntrana site, which Suntrana site was one of two work sites of the mining operations of the intervenor Usibelli Coal Mines, Incorporated. Defendant Pasa was not an officer,

director or stockholder of Usibelli Coal Mines, Incorporated. There were other foremen, equal in status and salary to defendant Pasa. Defendant Pasa was subject to the supervision of Mr. Waugaman, the General Manager of the corporation, as well as the officers of the corporation." (Tr. 75-78)

ARGUMENT OF APPELLEES

A. *Defendant Pasa Was Not An Executive Officer.*

The insurance policy in question was purchased by the Usibelli Coal Mines, Inc. from the third party defendants. They are the parties to the contract, and neither the plaintiff nor the defendant are parties to the insurance contract. That contract of insurance provides in paragraph III under "Definition of Insured" the following:

> "With respect to the insurance under coverages A, B, and D, the unqualified word 'insured' includes the named insured and also includes any executive officer, director or stockholder thereof, while acting within the scope of his duties as such, and any organization or proprietor, with respect to real estate management for the named insured. If the named insured is a partnership, the unqualified word 'insured' also includes any partner therein but only with respect to his liability as such."

Since it is conceded that Pasa is not a director or stockholder of the company, it only remains to determine whether he can be considered an "executive officer" of the Usibelli Coal Mines at the time of this accident. Clearly, he does not qualify as an executive officer.

The cases of *Bruce v. Travelers Insurance Company,* 266 F (2d) 781, (5th Cir. 1959) and *Employers Liability Assurance Corp. v. Upham,* 150 So. (2d) 595 (La. 1963) are well reasoned cases, directly in point, and should be decisive upon this issue.

In the *Bruce* case, *supra,* the court was dealing with a contention that a well drilling foreman named Collins, at all times under the supervision of an area superintendent of the Gulf Refining Company, was an "executive officer" of the company as that term was used in the policy of insurance. The Court of Appeals for the Fifth Circuit, speaking through Circuit Judge Wisdom, determined that the drilling superintendent was not an executive officer and stated as follows:

> "Nor can it be said a tool pusher or a ramrod or a supervisor at a well location functions in an executive capacity, as 'executive officer' is understood in the ordinary acceptance of the term. The term implies some sort of managerial responsibility for the affairs of the corporation generally and it imports a close connection with the board of directors and high officers of the company. Insurance policies should be construed liberally, but the words of a policy must be given the meaning they ordinarily bear. 'No strained or unusual construction should be given to any of the terms of a policy of insurance, in favor of the insurer or of the insured'. *Empire Life Insurance Co. v. Gee,* 1912, 178 Ala. 492, 60 So. 90, 92. Or, we add, in favor of a third party claimant."

In the *Upham* case, *supra,* the court was dealing with

a contention that one Shane, employed as a carpenter foreman by Upham Engineering Company, a general construction business, was an "executive officer" of the engineering company. It appeared from the evidence that Shane was not only under the direction of John D. Upham, but also of one Hoppmeyer ,general superintendent of the construction business. Although there was some evidence that Shane was occasionally referred to as a "superintendent", he himself conceded that he was actually hired as and was a foreman. He further admitted that there were other persons employed by the construction company in the same capacity as himself — that is, foreman. His duties consisted primarily of laying out work for his men, assigning the men to the work, and performing some general acts of supervision in connection with the job. He reported any unusual or emergent developments to his supervisor, Hoppmeyer. He described himself as a "plain foreman." The Louisiana court said:

> "None of the above facts are in dispute, and these, we think, clearly demonstrate that Shane's connection with Upham Engineering Company was not that of an 'executive officer' as we understand the term. He had no managerial authority nor anything to do with the operation of his employer's business, save in the capacity of workman — a carpenter-foreman."

The Louisiana court then supported its conclusion with a citation from the *Bruce* case, *supra,* set forth above, and then further cited from the *Bruce* case as follows:

> "'The distinction between an agent or employee and an officer is not determined by the nature of the work performed, but by the nature of the relationship of the particular individual to the corporation. * * *'"

It is clear that the defendant Pasa had no managerial responsibility for the affairs of the coal mining company generally and had no connection with its Board of Directors or high officers. It is further clear, when the nature of his work is considered, that his relationship to the corporation was that of employee and not agent or officer.

In their brief, appellants rely upon *Gordon v. Industrial Accident Commission of California*, 249 Pac. 44, in urging that a foreman such as Arthur Pasa should be classified as an executive officer under an insurance policy. The *Gordon* case, or cases, are easily distinguishable when the nature of what was there involved is considered. The California court did *not* hold that a foreman of a gravel pit operation was an "executive officer" for the purposes of determining the applicability of an insurance policy. The first *Gordon* case, 249 Pac. 844, decided by the District Court of Appeal, Second District, determined that the foreman, one Schienle, was not a "managing representative" of his employer in the sense that he was one who was "invested with the general conduct and control of a particular place of business of a corporation" as that definition had been established in the prior case of *Horst*

Co. v. Industrial Accident Commission, 193 P. 105, 194 Cal. 180.

In the next *Gordon* case, 249 P. 849, the Supreme Court of California held that Schienle was "managing representative" as that term was used in the Workmen's Compensation Act of the State of California. Neither of these cases, particularly the second one, purports to hold that a person in the position of a foreman, or one in the same position as defendant Pasa in this case, would be an "executive officer" under an insurance policy as that term is ordinarily understood and used in business relationships.

It is clear under the only applicable authorities in point that the defendant Arthur Pasa was not an executive officer of the Usibelli Coal Mines as that term was used in paragraph III of the insurance policy involved.

B. *Defendant Pasa was not a proprietor with respect to real estate management.*

In this portion of their brief, appellants argue that a coal mine is real estate and that Pasa was a "manager" of a coal mine, and based upon these two assumptions they arrive at the *non sequitur* that he must, therefore, be a "proprietor, with respect to real estate management for the named insured." The trial court succinctly disposed of this contention in its oral decision in the following words:

> "I also feel that he was not the proprietor, as that term is used in the policy. He was a foreman who had charge of a crew and managed a crew. He didn't have any management of the real estate as such, in the strict terms of the definition of a proprietor or an operator of real estate. His duties there were only for the purpose of running the crew during the shift of which he was in charge." (R. P. 90)

In the first place, of course, Pasa was not a "manager", but he was a foreman of men who were engaged in working upon and mining coal from a property in which he, Pasa, had no ownership or interest of any kind. A "proprietor" is synonymous with "owner" as that term is ordinarily and usually defined, understood and used. *Black's Law Dictionary, Fourth Edition.* Defendant Pasa does not qualify under such a definition.

In *Golmon v. Fidelity & Casualty Company of New York, Inc.*, 146 So. (2d) 461 (La.) 1962, a corporation operated a golf course. There was general control by its president, but in his absence, three employees were in charge of the company property, one of whom maintained the fairways and greens, and two of whom were young boys whose duties were to be at the club house and there collect greens fees and rent golf clubs. These boys, who collected the greens fees and rented the clubs, were as much in charge of that particular part of the property and in control of it as was the defendant Pasa in this case. An accident occured which was claimed to be the responsibility of one of the boys then in charge of the club

house, and it was contended he was insured under the policy of the defendant insurance company as it is here contended that Pasa was covered by such a policy. The Louisiana court said:

> "Counsel for plaintiff also contends that J. Leonard Collier, Jr. is an insured under the omnibus clause of the policy issued by defendant's liability insurer in the instant case for the reason that the omnibus clause of the policy states, in part, that the unqualified word "insured" includes:
>
> ' * * * any organization or proprietor with respect to real estate management for the named insured.'
>
> Counsel for plaintiff cites no authority in support of his position, and after a review of the facts in the instant case, we are of the opinion that the duties of the said J. Leonard Collier, Jr. were of such a nature that he was an employee of the corporation rather that the proprietor managing real estate, and consequently, the omnibus clause of the policy is not applicable to the instant case."

Defendant Pasa was not a proprietor, nor did he have the management of any real estate as such at the time of this accident, and he was not insured under the policy in question.

C. *The proper construction of the insurance contract would not include Pasa as an insured thereunder.*

It is urged by the appellants that insurance contracts are to be strictly construed against the company issuing such contracts and in favor of the "party claiming cover-

age." The rule is that such contracts are normally construed liberally in favor of those who are parties to the contract and who have paid premiums in order to obtain the benefit of the coverage to be provided. Neither appellant can qualify as a party to the insurance contract in question, and they are in no position to urge that they are entitled to have any court strain the language of the policy in an effort to bring them under its coverage.

In any event, appellants are not really contending for a liberal construction of the policy in question, they are contending for a wholly unwarranted and unintended construction of clear and unambiguous language in the policy. What was said by Judge Wisdom in the *Bruce* case, *supra,* is peculiarly applicable to the contention which the appellants here make with respect to the construction to be placed upon the policy. Judge Wisdom said:

> "Insurance policies should be construed liberally, but the words of a policy must be given the meaning they ordinarily bear. 'No strained or unusual construction should be given to any of the terms of a policy of insurance, in favor of the insurer or of the insured'. *Empire Life Insurance Co. v. Gee,* 1912, 178 Ala. 492, 60 So. 90, 92. Or, we add, in favor of a third party claimant."

D. *It is the function of this court upon review to accept all findings of fact of the trial court unless they can be said to be clearly erroneous.*

It is suggested by the appellants that the evidence in this case is "undisputed" and that, accordingly, this court

"can completely review and render determinations as to all facts and law with respect to this case" (App. Br. 22). Appellees submit that under Rule 52 (a) of the Federal Rules of Civil Procedure, 28 *U.S.C.A.*, this court must accept any findings of fact of the trial court unless those findings are clearly erroneous. This court has so stated. *Bloom v. United States,* 272 F (2d) 215; *United States v. United States Gypsum Co.,* 1948, 333 U.S. 364, 68 S. Ct. 525, 92 L. Ed. 746. This rule would apply even if the basic facts were undisputed as claimed by appellants. *Lundgren v. Freeman,* 307 F (2d) 104; *Commissioner of Internal Revenue v. Duberstein,* 1960, 363 U.S. 278, 80 S. Ct. 1190, 4 L. Ed. 2d 1218.

The Findings of Fact made by the trial court, which are pertinent on this appeal and which have been set forth in the counterstatement of the case herein, are abundantly supported by the evidence. The conclusions of law which the trial court drew from those facts are supported by the authorities, by common sense, and sound reason.

CONCLUSION

For all the reasons set forth herein, the Findings of Fact and Conclusions of Law of the trial court should be accepted and approved, and its decree should be affirmed by this court.

Respectfully submitted,

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Attorneys for Appellees

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rnules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing brief is in full compliance with those rules.

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No. 19985

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Seattle
Vol. 3348

MORRIS STEINBERG,

Appellant,

vs.

J. L. DORFMAN, *et al.*,

Appellees.

APPELLANT'S REPLY BRIEF.

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No. 19985

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MORRIS STEINBERG,

Appellant,

vs.

J. L. DORFMAN, *et al.*,

Appellees.

APPELLANT'S REPLY BRIEF.

Appellees' Statement of the Case.

Appellees' reply brief does not offer a sustained argument substantiating their position but rather contains a hodge-podge of contentions which are not related to the conclusions which they desire. The purported facts set forth in Appellees' statement of the case are misleading and for the most part, erroneous. Appellees state: "He made money in his business; he did not lose" (Appellees' Br. p. 2). Reference is made to the Bankrupt's testimony at the continued first meeting of creditors. However, it has been demonstrated that the Bankrupt was not his own accountant and did not know the profit and loss figures or the particular information contained in the books and records [Rep. Tr. Vol. 3, pp. 20, 65, 66, 72, 73, 75]. Question by Mr. Elmore: "You did make money in your business?" Answer by Mr. Steinberg: "Whatever is on the record" [Rep. Tr. Vol. 3, p. 72]. Furthermore the certified public accountant testified that the business reflected a loss of $3,671.00

from March 31, 1961, to March 31, 1962; a loss of $8,700.00 from March 31, 1962, to March 31, 1963; and a loss of $4,000.00 from April 1, 1963, to September 30, 1963 [Rep. Tr. Vol. 4, p. 56]. There were no profits from which the Bankrupt could obtain moneys in addition to those he accounted for.

Appellees state: "Moneys loaned to him for the purpose of operating his scrap metal business, all incurred within a year or so prior to his bankruptcy [Ex. 2, p. 27]" (Appellees' Br. pp. 2-3). There is no language remotely connected with this assertion at the cited portion of the testimony at the continued first meeting of creditors. Furthermore the Bankrupt testified that moneys were loaned to him over a three year period and the purpose was sometimes personal, sometimes business and bookkeeping entries were made accordingly [Rep. Tr. Continued First Meeting, pp. 6-7].

Appellees state: "He testified that he lost about $160,000.00 in gambling. This was 'just a guess'; he had 'no way of really keeping it accurate' but it was 'his best judgment'" (Appellees' Br. p. 3). This may be an approximation of what the Bankrupt said at the continued first meeting of creditors but it is misleading because the Bankrupt further testified that his estimate of $160,000.00 losses covered the three year period prior to bankruptcy and furthermore the Bankrupt explained in detail each gambling transaction and the amount won or lost for the year period prior to bankruptcy at the hearing on objections to discharge. He testified that he had refreshed his recollection through reference to various records and conversations and that the amount lost by him in the year prior to bankruptcy was $93,000.00. This amount was established as all that was available.

Appellees claim: "He made no entries in his bank records of any of these counter or customer's checks which he used for gambling, and there were many of these in substantial amounts" (Appellees' Br. p. 4). There is no such testimony at the section cited [Rep. Tr. Vol. 3, pp. 38-40] even if there were such language, it would not be of import. The counter checks which were referred to were merely further evidence that gambling in fact took place as the payees were often indicative of the place of the expenditure of funds. The business books of account do not reflect transactions which do not pertain to the business, and so the personal counter checks were properly not entered on the business records. The moneys drawn from the business of the Bankrupt and charged to his drawing account on a personal basis are available to the Bankrupt to be utilized as desired and all that the bankruptcy law requires is that a satisfactory explanation be made of any losses incurred. This has been done.

Appellees assert: "He made no entries in his business books of these winnings" (Appellees' Br. p. 4). This contention, repeatedly argued by the Appellees, is indicative of the fact that the Appellees have never understood what accounting principles are properly applicable herein. The ultimate source of deposits made to the business bank account is not relevant in determining whether bookkeeping methods were adequate. The cash receipts journal merely reflects the person who issued the check deposited or the person who contributed the cash deposited. When money is received, a debit is made to the cash account and a credit is made to a loan payable or to sales or to the capital account if the person contributing was the Bankrupt. It does not

matter where the Bankrupt got the funds he contributed. A credit is made to his capital account regardless of the source. As a matter of fact, substantial contributions to capital were made by the Bankrupt but even if he had made none, this would not be a basis or a ground for objecting to discharge. He need not have deposited any gambling winnings. Nevertheless, the Bankrupt testified at great length that winnings were in part retained for further gambling and in part deposited into the business bank account [Rep. Tr. Vol. 4, pp. 3, 6, 26].

Appellees' refusal to accept the Bankrupt's statement that he sent his employee, Wade Watson, to the race track without getting a receipt for moneys entrusted (Appellees' Br. p. 5) denotes a tinge of class consciousness on behalf of Appellees and also indicates a lack of understanding of human relationships. The Bankrupt's testimony is not in the slightest discredited because of his trust and affection for Mr. Watson or the Bankrupt's obvious loose method of handling funds.

Appellees contend Bankrupt was not too precise about his race track activities, citing language such as "probably", "usually", "I figured" and "I am not positive" (Appellees' Br. p. 5). As stated in Appellant's Opening Brief herein, the Bankrupt could not reasonably be asked to state the amount of each and every betting transaction entered into or its disposition because the event took place too quickly for recordation. Nevertheless the Bankrupt testified at length as to dates, places, persons present and approximate amounts of winnings and losses as to each gambling transaction entered into. His testimony was corroborated. All funds available were shown to have been expended. No

more is required. Furthermore, as pointed out in Appellant's Opening Brief, the Appellees have failed to sustain their burden of proof as to each of the grounds asserted as a bar to discharge and therefore there need not even be a consideration of Bankrupt's explanation of losses.

Appellees' statement that the Bankrupt's accountant confirmed a loss of $160,000.00 (Appellees' Br. p. 6) is without merit. The accountant merely replied in the affirmative to a statement by counsel that losses had been claimed [Rep. Tr. Vol. 4, p. 69].

Appellees state: "The Bankrupt testified he used the word 'loan' to cover up for gambling" and "The accountant testified that the use of the word 'loan' was not keeping adequate records" (Appellees' Br. pp. 6-7). Again, the argument of Appellees misses the point. If moneys are withdrawn by the Bankrupt they are charged to his drawing account whether the notation "personal use for gambling" or the notation "personal use for payment of personal loan" is made. This is standard accounting procedure, is not deceptive, and does not change the income statement or the balance sheet of the business. In addition, if money is contributed to the business by the Bankrupt, his capital account is credited whether a notation is made "I got the money from gambling winnings" or "I got the money from a personal loan." As a practical matter, the type of notations indicated are not made because they have no relevance. The accountant testified he was not too concerned about the reason for withdrawals because if it did not reflect a business entry, he simply charged the Bankrupt's drawing account [Rep. Tr. Vol. 4, p. 64].

Appellees claim: "The accountant admitted that the Bankrupt's records showed 'only what you could determine from the records he gave you or from the information he told you verbally" (Appellees' Br. p. 7). It is axiomatic that business records must be prepared from information supplied by the businessman. This makes no argument for Appellees whatsoever. The accountant testified that these books were kept in the same manner as other businesses of this type according to standard accounting principles and they reflect the business transactions and financial condition of the Bankrupt [Rep. Tr. Vol. 4, pp. 51, 53]. Furthermore the accountant testified that the information from which the books and records were prepared was a reflection of the activities of the Bankrupt's bank accounts [Rep. Tr. Vol. 4, p. 52] and so a check and balance was put upon the data submitted by the Bankrupt.

Appellees state: "The accountant admitted that he could not relate the Bankrupt's records to standard accounting principles, and that practices used by the Bankrupt were not keeping adequate records" (Appellees' Br. p. 7). The cited references [Rep. Tr. Vol. 4, pp. 80-81] do not support the assertion of Appellees. At page 80 of Volume 4 of the Reporter's Transcript, counsel for Appellees asked the witness to relate the Bankrupt's methods rather than the accountant's methods to standard accounting principles. The two cannot be separated because they depend upon each other. The witness was not given a chance to complete or explain his answer. His previous testimony clearly indicated that standard accounting principles were followed: "The condition of the books and records is that they adequately reflect the transactions of the business entity" [Rep.

Tr. Vol. 4, p. 46]. As to the statement by the accountant at page 81 of Volume 4 of the Reporter's Transcript that showing the word "loan" for a gambling transaction is not keeping adequate records, the preceding colloquy must be considered in which the accountant's position that the books were adequate was clearly stated. The question before the witness was vague and confusing. The accountant further testified [Rep. Tr. Vol. 4, p. 86] that the Bankrupt did keep adequate records of all of his transactions.

Appellees' Statement of Findings of Fact and Conclusions of Law.

Bankrupt accepts Appellees' statement of the findings of fact. Bankrupt recognizes the general rule that such findings must be shown to be clearly erroneous. This general rule prevails whether a review is taken to the District Court from the referee's decision or not. The citation at page 13 of Appellees' brief does not bear out their contention that the burden is increased under these circumstances. It is contended by Bankrupt that Findings of Fact did not follow from the evidence presented and that such findings were clearly erroneous. Each of the findings and the conclusions following therefrom are challenged by Bankrupt on the basis set forth in Appellant's Opening Brief. Adequate records were kept and introduced by the Bankrupt and a complete and satisfactory explanation was made of the loss incurred. Appellees furthermore failed to sustain their burden of proof as to each of their asserted grounds for objection to discharge.

Appellees' Argument.

Appellees claim: "He endeavored to account for the losses of large sums of money by nothing more than his memory and his word-of-mouth evidence" (Appellees' Br. p. 13). This is an incorrect appraisal of the circumstances. The Bankrupt introduced checks specifically related to a particular gambling incident, check stubs, race track loss tickets in large denominations in sequence for the time period in question and a sheet, properly authenticated, with the names, dates and amounts bet, won and lost on particular horses. The statements of the Bankrupt were corroborated by the witnesses Carl Segal and Wade Watson. Had the Bankrupt not had documentation of his gambling transactions, his testimony alone would be sufficient. There has been no showing by Appellees that the testimony of the Bankrupt alone would not suffice. The question is not whether there is documentation but whether the Bankrupt sufficiently details his explanation so that it is plausible and complete. Here, the Bankrupt specifically enumerated each betting transaction in which he was involved in the year prior to bankruptcy, setting forth the time, the place, the persons present, the amount available, the type of betting transaction, the amount bet and the amount won or lost. This testimony was not contradicted and was sufficient.

Appellees' Statement Regarding Adequacy of Records.

Appellees cite *Matter of Underhill,* 82 F. 2d 258 (C.C.A. 2nd Cir.) at page 14 of their brief for the proposition: "Records of substantial completeness and accuracy are required so that they may be checked against the mere oral statement or explanations made by the

Bankrupt." The records referred to are business records and the Bankrupt in the instant matter has introduced such records and his certified public accountant has stated that the records were adequate to determine business transactions as well as financial condition. Oral explanations have been made by the Bankrupt regarding his personal expenditures, particularly gambling. This testimony has been corroborated. Furthermore, documentation concerning personal expenditures has been introduced. The requirement set forth in *Underhill* is amply satisfied. In this regard the statement in *Remington on Bankruptcy,* Sec. 3111, page 232, that records are not required for personal expenditures, is pertinent.

Appellees cite *In re Davis* (E.D.N.Y. 1962), 208 F. Supp. 508 at page 15 of their brief for the proposition that the Bankrupt cannot escape on the ground that gambling losses are a personal expense. However, this case, as is the situation in all other cases cited by Appellees, turns on the fact that the Bankrupt did not explain his gambling loss. The Court states: ". . . but maintained no records of dates or amounts of wagers, or of tracks at which, or horses upon which, he wagered, where he offered no corroborating testimony or details as to losses and no explanation for failure to keep books, records or evidence of losses except that they were gambling losses" (Appellees' Br. p. 15). The Bankrupt in the instant matter detailed his losses, had records supporting his allegations and offered corroborating testimony.

Appellees argue at page 16 of their brief that one who gambles should be required to keep records of each gambling session and then enter the same in his busi-

ness books, and also to deposit the winnings in her business bank account. No authority is cited and this is simply not the law; rather it is a statement of Appellees' preferences. The business books are records of business transactions and by definition do not include such matter. The question of deposit of winnings has been previously considered and shown to be an irrelevant argument based on Appellees' lack of understanding of accounting methods.

Appellees state: "His checks and check stubs were wholly insufficient and incomplete. They were not all presented. He could not explain their absence. A great many checks were so-called counter or customer's checks obtained from hotels or gambling establishments payable to cash, not reflected in his check stubs at all" (Appellees' Br. p. 16). Appellees do not tell us for what purpose the Bankrupt's checks and check stubs must be sufficient and complete. There is no requirement that checks and check stubs be kept. The only requirement involved in determining adequacy of records is whether books of account were kept and whether such books were sufficiently complete and correct. There is no contention here that the books themselves were not adequate. As previously stated, the fact that counter checks were made by the Bankrupt has no significance in determining adequacy of the books and records because personal expenditures are not properly included in the business records.

Appellees argue: "Stubs were incomplete, in many cases without even a notation of the amount or name or date. The Bankrupt even mislead his own accountant telling him many of these checks cashed and moneys were the subject of loans." (Appellees' Br. p. 16).

Again, it must be pointed out that we are concerned with the adequacy of the books and records, not with the adequacy of the check stubs. Information not present on check stubs or determinable from the payee of the check may properly be determined from the statements of the businessman. There was no misleading of the accountant by the Bankrupt in designation of the purpose of the particular checks made. When a non-business payee was designated, the checks were properly charged to the drawing account of the Bankrupt. This is standard accounting technique which apparently is lost on Appellees.

Appellees state: "In numerous cases he could not even identify the handwriting of the person who wrote the word 'loan.' He ran his business and personal accounts together." (Appellees' Br. p. 17). What the significance of the Bankrupt's being unable to identify the handwriting of the person who wrote the word "loan" is not made clear, if such was in fact the case. Appellees cite Reporters Transcript Vol. 4, page 27 for their statement that the Bankrupt ran his business and personal accounts together. There is no language at the cited reference which even remotely approximates the statement of the Appellees. The Bankrupt did not run his business and personal accounts together, but if he had, it would not be grounds for bar of discharge.

Appellees claim: "Even his accountant testified that there was no record of the deposit of any gambling winnings." (Appellees' Br. p. 17). Appellees cite Reporter's Transcript Vol. 4, page 33 for reference to the comment made. The section cited contains no language whatsoever connected with the statement made by Appellees. No such testimony was made by the accountant.

Appellees state: ". . . he claims that all he won was $10,000, $8,000 and $1,000 twice, an utterly preposterous contention. He does not appear to be a novice at this type of activity; he had considerable experience." (Appellees' Br. p. 18). Experienced gamblers have been known to indulge in innumerable sessions of gambling without producing a winning session. A claim of winnings as set forth by Appellees would certainly not be preposterous. However, such was not the contention of the Bankrupt. For example, the Bankrupt testified [Rep. Tr. Vol. 2, p. 22] that he won $2,500 dollars on his personal trips to Hollywood Park. Furthermore, the Bankrupt testified that the horses given to him as part of the Pete Moreno swindle oftentimes produced winnings but that the net result was a loss [Rep. Tr. Vol. 2, p. 34].

Appellees assert: "Here, the 'losses' do not square with the deficiency in assets, and the business transactions cannot be ascertained from the records." (Appellees' Br. p. 18). The losses sustained by the Bankrupt in his gambling transactions "square" exactly with the assets shown to have been available during the year prior to bankruptcy and to have been dissipated in that period. Appellees' statement that that the business transactions cannot be ascertained from the records is without merit and simply ignores the realities of the books of account submitted as evidence and the testimony of the certified public accountant who prepared them.

Appellees' Statement Regarding Explanation of Losses.

Appellees cite *Siegal v. Cartel,* 164 Fed. 691 (C.A. 9, 1908) for the proposition that a person who gambles will not be granted a discharge in bankruptcy (Appellees' Br. p. 20). It is necessary only to look to the language of the Court in the *Siegal* case to determine the basis for denying discharge in bankruptcy: "He did not introduce any evidence corroborative of the losses at gaming. He failed on close inquiry to give the name of one person with whom he played or the name of the proprietor of the establishment where he played . . . he could give no particular dates or particular sums lost at the 'sittings' " (Appellees' Br. pp. 20 and 21). The facts in that case are completely different from the facts in the instant matter. The Bankrupt here made a complete and full explanation which would easily have satisfied the various tests set forth in the *Siegal* case.

Appellees cite *Gaudet v. Cowen,* 297 F. 2d 227 (C.A. 5, 1961), cert. den. 370 U.S. 950, 8 L. Ed. 815, 82 S. Ct. 1598, as a case standing for the proposition that the Bankrupt should be denied discharge because of failure to keep books and records (Appellees' Br. p. 21). Again, the language of the Court must be looked to: "He had no cancelled checks, check stubs, bank statements, records of receipts or expenditures. He failed to make such disclosure as is a condition precedent to discharge." (Appellees' Br. pp. 21 and 22). The facts established in *Gaudet* are significantly different than the facts established in the instant matter.

Another case regarding denial of discharge because of gambling losses sustained cited by Appellees is *Crider v. Jordan,* 255 F. 2d 378 (C.A. 4, 1958) (Appellees'

Br. p. 22). A complete response to Appellees' inference is contained in the language of the Court in that case: ". . . he kept no records and retained no memory of the details of his losses . . . $10,000 of assets disappeared without any record whatsoever being made on the books or any explanation of its disposition . . . without any explanation except that it had disappeared in gambling transactions of which the Bankrupt had no records and no definite recollection" (Appellees' Br. pp. 22 and 23).

Appellees claim: "His deposits and withdrawals and general loss of assets do not coincide; there is a half-baked attempt to reconcile the figures obtained by the accountant, in part, on information in the schedules in bankruptcy, which attempt itself has failed. The accountant could not even explain why he needed to consider the Bankruptcy Schedules" (Appellees' Br. p. 23). How deposits and withdrawals and general loss of assets would coincide in any circumstances is unknown since they have no relevance to one another. The basis of the Appellees' comment that the record of cash flow prepared by the C.P.A. "has failed" is not explained. As pointed out in Appellant's Opening Brief herein, the bankruptcy schedules were properly utilized to determine the statement of cash flow since the bankruptcy schedules are the statement of the Bankrupt, under oath, of his liabilities at the time of bankruptcy. The schedules are based upon the records of the Bankrupt, the knowledge of the Bankrupt, the data of the various creditors as it is available to the Bankrupt. This checked against the proofs of claim in bankruptcy. Some is not hearsay, it is a statement of fact and can be of these liabilities were entirely personal so were not re-

corded on the books of account of the Bankrupt. But the moneys obtained were available during the period in question, so those amounts not reflected in the business records must necessarily be included in a statement showing all cash available and all cash distributed. The accountant explained quite adequately why he needed to consider the Bankruptcy Schedules [Rep. Tr. Vol. 4, p. 92].

Appellees state: "The Bankrupt produced in evidence Exhibit F, two sheets with a list of horses on which he bet and had substantial losses; they contained numerous hieroglyphics which are not intelligible to anyone looking at the documents and even he had difficulty in deciphering it. The items were not reflected in his permanent records." (Appellees' Br. p. 24). The list of horses involved in the Pete Moreno swindle was explained at length by the Bankrupt and testimony was given which indicated the name of each horse bet on, the amount bet on the horse and the disposition of the bet. This certainly makes the document decipherable and lays a complete and proper foundation for its introduction into evidence which was not objected to by Appellees. The fact that the items on the list of horses were not transferred to the permanent records is of no consequence since this data is not properly a part of the business books and records. Again, Appellees fail to demonstrate cognizance of basic accounting practices.

Appellees state: "There was no explanation why he had no gambling tickets covering losses at Bay Meadows or Del Mar, race tracks away from Los Angeles, where he also placed substantial bets and had large losses." (Appellees' Br. p. 25). It is not common to retain race track tickets reflecting bets on losing horses. There is

no requirement that this be done and it is not necessarily a part of an explanation of gambling losses. The fact that the Bankrupt had substantial sequence tickets from bets made at Hollywood Race Track is simply further corroborative evidence of the fact that the Bankrupt did gamble. Appellees' suggestion that there must have been losing race track tickets submitted by the Bankrupt in order for him to make a proper explanation of his gambling losses is indicative of the overall manner in which the Appellees have approached this matter. They have raised irrelevant and inconsequential factors and argued heatedly that their own dissatisfaction with the submissions of the Bankrupt as to these irrelevant and inconsequential matters is determinative of the disposition to be made in this matter.

Appellees' Conclusion.

Appellees argue: "This is without a doubt a most flagrant case of dissipation of assets to come before a bankruptcy court. The amount of the losses claimed to have been lost at gambling far exceeds the losses in any of the reported cases" (Appellees' Br. p. 27). This statement summarizes the misconception with which Appellees have approached this matter from its inception. Dissipation of assets is not a grounds of discharge. Gambling is not a grounds of discharge. No matter how substantial the loss of assets is, if a satisfactory explanation is made of such loss, discharge must be granted. Appellees are attempting to add a new statutory ground for the denial of discharge and their attempt should be viewed not emotionally, as has been done thus far, but realistically in the light of the existing bankruptcy statutes and requirements. The Bankrupt had adequate records. The Bankrupt satisfactorily explained his loss.

Furthermore, the Bankrupt need not have responded to the unsupported allegations of Appellees. Appellees came forth with no evidence of their own. No expert witness was produced by them concerning adequacy of books and records. No testimony was offered by them in any way contradicting or diminishing the detailed explanation of Bankrupt. Their entire cases rests upon the statements of Bankrupt made at the continued first meeting of creditors. These statements have not been shown to be a basis for establishing the claims of Appellees and in addition, the Bankrupt's testimony has been amplified and made more specific by his comments at the hearing on discharge. Appellees cannot accept what they feel suits their purpose of Bankrupt's testimony, reject the balance without evidence and claim they have made a case by sitting idly by. The referee's decision as well as the decision of the district judge on review should be reversed.

Respectfully submitted,

BROWN & BROWN,
By HOWARD B. BROWN,
RODNEY MOSS,
Attorneys for Appellant.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

RODNEY MOSS

No. 19987

In the

UNITED STATES COURT OF APPEALS

For the Ninth Circuit

JOHN S. GORSUCH,

Appellant,

vs.

FIREMAN'S FUND INSURANCE COMPANY,

Appellee.

See also Vol. 3349

OBJECTION TO DUHAME'S MOTION TO INTERVENE AND FOR LEAVE TO FILE A PETITION FOR REHEARING

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FILED

No. 19987

In the

UNITED STATES COURT OF APPEALS

For the Ninth Circuit

JOHN S. GORSUCH,

Appellant,

vs.

FIREMAN'S FUND INSURANCE COMPANY,

Appellee.

OBJECTION TO DUHAME'S MOTION TO INTERVENE AND FOR LEAVE TO FILE A PETITION FOR REHEARING

Fireman's Fund Insurance Company, hereinafter called "Surety", objects to the Motion to Intervene and For Leave to File a Petition for Rehearing filed by the co-executors of the Estate of Elmer W. Duhame, Deceased, hereinafter called the "Duhame Executors" or "Duhame", and respectfully prays that said motion and petition be denied.

ARGUMENT

I. The Duhame Executors Were Parties To The Appeal

The Duhame Executors cry out that they "have effectively been precluded from raising the issues . . . before either the trial of Appellate Courts . . ." (Duhame's Motion p. 7) The fact is that they were parties to the appeal, but chose to sit it out and should not now be heard to complain:[1]

1. Only one Judgment, dated December 17, 1964, was entered. (R. 89)

2. Gorsuch filed a Notice of Appeal "from the final judgment entered in this action on December 17, 1964." (R. 94); and the Clerk of the District Court mailed a copy thereof to Duhame's attorneys. (R. 101)

1. The principle here involved is not unlike that in State v. Armijo, 39 N.M. 502, 50 P.2d 852, 855 (1935) where the Court, in ruling on the timeliness of an affidavit of disqualification of a judge, said:

> "We cannot permit a litigant to test the mind of the trial judge like a boy testing the temperature of the water in the pool with his toe, and if found to his liking, decides to take a plunge. The plunge into the pool of litigation with an affidavit disqualifying the trial judge must be made on a belief of prejudice theretofore entertained, and not on any subsequent discovery of such belief of prejudice resulting from an adverse ruling."

3. The Bond for Costs on Appeal designated the Duhame Executors as obligees. (R. 96)

4. The Designation of Contents of Record on Appeal was served on Duhame's attorneys; it, too, referred to the appeal "from the final judgment". (R. 95)

5. Duhame's attorney was present at the hearing before the District Court on Gorsuch's motion to dismiss for want of an indispenable party and orally resisted said motion in addition to urging the Duhame motion for summary judgment. (R. 99, Minute Entry of Oct. 12, 1964) Duhame served the latter motion upon Gorsuch (R. 72) who of course was involved therein and who appealed from the summary judgment as well as the remainder of the judgment.

6. The Statement of Points filed by Gorsuch was served on Duhame and included specifications that the District Court erred in granting the Duhame motion for summary judgment and in ordering the return of the Duhame collateral. (R. 104)

7. Gorsuch's opening brief in this Court included specifications that the District Court erred in granting the Duhame motion for summary judgment and in ordering the return of the Duhame collateral. (Brief for Appellant, pp. 7, 8)

8. Duhame chose not to file a brief in this Court, notwithstanding his knowledge of the above specifications.

The foregoing facts appearing of record, we submit, disclose that the Duhame executors were not "effectively" or at all "precluded from raising the issues" before either the District Court or this Court. In addition, and here we go outside the record, as has Duhame's attorney:

(a) On June 29, 1965 Surety's attorney wrote Duhame's attorney:

> "Because of the indemnity agreement executed by Elmer W. Duhame and Dr. Angus J. DePinto, the Duhame Estate and Dr. DePinto are interested in the outcome of the appeal; more particularly, in having the judgment entered by Judge Craig affirmed. In view of this fact I will appreciate any suggestions you or Joe Jenckes may have with regard to the brief to be filed on behalf of Fireman's Fund Insurance Company."

(b) On January 24, 1966 Surety's attorney wrote Duhame's attorney advising him of the date set for oral argument in this Court ". . . in order that he also may take such part therein as he may feel will be in the best interest of the Duhame Executors." On February 7, 1966 Duhame's attorney called Surety's attorney and said he felt the briefs covered the matter fully, that he felt he could not contribute anything at oral argument and <u>for those reasons</u> he deemed it unnecessary to take any part in the argument.

II. The Relief Sought on Rehearing Is Not Proper

The sum and substance of the pending motion, as urged by the Duhame Executors, is that this Court erred in not ordering a dismissal of the action; and they seek to have the following language deleted from the opinion:

> "We do not direct dismissal of the action because Fireman's Fund Insurance Company may wish to proceed against Duhame and DePinto to recover the cash and corporate stock which it was erroneously ordered to transfer to them."

We do not agree.

This Court, on an appeal from the entire judgment and not merely from a part thereof, has held that Doig was an indispensable party, that the District Court should have dismissed the complaint and that it erred in not doing so. Instead, the District Court ordered the Surety to release $350,000 in cash and corporate stock. It also adjudged the Surety guilty of contempt and fined it $1,750 per week for its failure to surrender the cash and corporate stock. (R. 101) Faced with this situation the Surety had no alternative; it surrendered the collateral it had been holding and thus purged itself of the contempt and the fine.

If the complaint had been dismissed by the District Court, as this Court has held should have been done, the Surety would still have possession of the cash and stock.

Under these circumstances it was but natural and just and right that this Court point out the way for the District Court, on motion of the Surety, to correct its error and restore the status quo by ordering the return of the collateral. Only in this manner can justice be accomplished, for surely the Duhame Executors should not be permitted to keep that which they should not have received in the first instance.

The fact that Duhame subsequently settled with Doig and Provident, and that a decree of distribution has been entered in the Duhame estate, are beside the point. The settlement was made because Duhame deemed it to be in the estate's best interest that this be accomplished. The wherewithal so to do was the collateral held by the Surety which the District Court erroneously ordered released to Duhame.

CONCLUSION

Duhame's motion (pp. 3, 4) cited and quoted from Mulaney v. Anderson, 342 U.S. 415, 96 L.Ed. 460 (1952). We

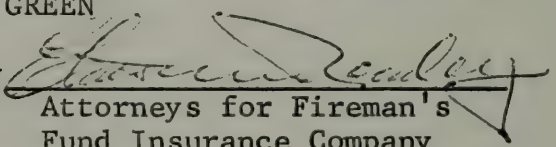
think the quoted language applies here. The "special circumstances" before this Court more than justified the language Duhame now seeks to have deleted. To delete the same, we submit, would "run counter to effective judicial administration. . . "

Duhame would have this Court believe that the equities require that the language in question be deleted from the opinion. The contrary, we submit, is true.

The Duhame motion and petition should be denied.

Respectfully submitted,

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By 
Attorneys for Fireman's
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Copy of the foregoing mailed
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No. 19996

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Seeples
Vol. 3349

NATIONAL LABOR RELATIONS BOARD,

Petitioner,

vs.

CADILLAC STEEL PRODUCTS CORPORATION,

Respondent.

On Petition for Enforcement of an Order of the National Labor Relations Board.

Respondent's Petition for a Rehearing.

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United States Court of Appeals

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vs.

CADILLAC STEEL PRODUCTS CORPORATION,

Respondent.

On Petition for Enforcement of an Order of the National Labor Relations Board.

Respondent's Petition for a Rehearing.

To the Honorable Richard H. Chambers, Stanley N. Barnes and Ben Cushing Duniway, Circuit Judges:

Cadillac Steel Products Corporation, Respondent herein, pursuant to the provisions of Rule 23 of this Court, hereby respectfully petitions for a rehearing of the within cause upon the following grounds:

I.

The crucial question in this case is whether Respondent was entitled to a hearing at some stage of the representation and unfair labor practice proceedings upon the substantial and material factual issue whether an employee, whose vote would have affected the outcome of the election, failed to vote, due to his own fault or

because of irregularities in the election procedure which led the employee to believe that he had to wait until his name was called to vote.

The Court held that the Regional Director had the discretion to determine the reason for the employee's failure to vote without a hearing though there was a conflict between the facts presented by Respondent by way of affidavits and the facts developed by the Regional Director in an *ex parte* investigation. The sole basis for the Court's holding appears to be that Respondent signed a consent election agreement which left it to the Regional Director to determine whether a hearing should be held in disposing of objections and challenges [Sl.-0. 2]. The court reasoned that, by signing the consent agreement, respondent waived all rights to a hearing, as authorized by section 9(c)(4), 29 U.S.C. §159(c)(4). (*ibid.*)

In so holding, the Court failed to consider the crucial distinction between the waiver of a pre-election hearing, contemplated by section 9(c)(4), and the waiver of a post-election hearing on objections or challenges. The obvious purpose of section 9(c)(4), is to avoid the delay of elections by unnecessary *pre-election* hearings where there are no issues as to the scope of the appropriate bargaining unit, or any other matter which would require such a hearing. A party which signs an Agreement for Consent Election knows at the time of signing whether any such issues do exist and is therefore in the position of waiving a *pre-election* hearing with full knowledge of all applicable facts. In contrast, at such time no party could possibly know whether the election will result in objections or challenges, yet alone whether any such objections or challenges will involve disputed

factual issues. That the Agreement for Consent Election contemplates such a total waiver of a hearing on objections or challenges is made even more implausible by the fact that the waiver was held here to extend even to the ensuing unfair labor practice proceeding.

Waivers of a hearing in an unfair labor practice proceeding are not authorized by section 9(c)(4). The right to a hearing in an unfair labor practice proceeding is not merely granted by the Act but is protected by the Constitution (see Resp. Br. 18-19; 30-32). It should not be implied, in the absence of express language of waiver, that such an important right is waived by an agreement which has as its real purpose the expedition of elections. If it were to be the law that a party to a consent election agreement waives all rights to post-election hearings, without any recourse under any circumstances such agreements would rapidly fall into disuse because most parties would become reluctant to sign them.

II.

The Court stated that this case is controlled by *N.L.R.B. v. Carlton Wood Products Co.,* 201 F. 2d 863 (9 Cir., 1953) and relied further on *N.L.R.B. v. Hood Corp.,* 346 F. 2d 1020 (9 Cir., 1965) and *N.L.R.B. v. Sumner Sand & Gravel Co.,* 293 F. 2d 754 (9 Cir. 1961). (Sl.-0. 2). Actually the holding in the instant case is contrary to the principles of law set forth in the *Carlton* and *Hood* cases.

In *Carlton,* the Court stated that the Regional Director could proceed *ex parte* only because there were no disputed basic facts. (291 F. 2d at 867). This important limitation was disregarded by the Court in this case. In *Hood* the Court held that the consent agree-

ment required the Regional Director to comply with the Rules and Regulations of the Board (346 F. 2d at 1022) (Resp. Br. 15-20). The consent form used in the instant case was issued by the U.S. Government Printing Office in 1961 [Tr. 6] and must have been the same as the form used in the *Hood* case. Yet here the Court has held, in effect, that the Regional Director may disregard the Board's Rules and Regulations which require post-election hearings in consent cases where there are substantial and material factual issues (Resp. Br. 16-18).

Conclusion.

For the reasons set forth above the Petition for a Rehearing Should be granted.

Respectfully submitted,

LOEB AND LOEB,
HARRY J. KEATON,
Attorneys for Respondent, Cadillac Steel Products Corporation.

Certificate of Counsel.

I am of counsel of record for respondent and certify that in my judgment this petition is well founded and that it is not interposed for delay.

HARRY J. KEATON

Dated, Los Angeles, California,
February 1, 1966

NO. 20002

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

See also Vols. 3349, 3350, 3366

TOOL RESEARCH AND ENGINEERING CORPORATION,

Appellant,

vs.

HONCOR CORPORATION,

Appellee.

APPELLANT'S PETITION FOR REHEARING

APPEAL FROM
THE UNITED STATES DISTRICT COURT FOR
THE CENTRAL DISTRICT OF CALIFORNIA

FILED

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NO. 20002

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FOR THE NINTH CIRCUIT

TOOL RESEARCH AND
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NO. 20002

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

TOOL RESEARCH AND
ENGINEERING CORPORATION,

Appellant,

vs.

HONCOR CORPORATION,

Appellee.

APPELLANT'S PETITION FOR REHEARING

Appellant, Tool Research and Engineering Corporation, petitions for a rehearing under Rule 23 on the grounds that this Court misapplied Smith & Griggs Mfg. Co. v. Sprague, 123 U.S. 249 (1887), in its Opinion sustaining the lower Court's holding of invalidity of U. S. Letters Patent No. 2,975,263.

After stating that none of the previously considered rules "quite compel a result here", this Court turned to Smith & Griggs, supra, and erroneously concluded:

> "... that the sale of a product made by a machine not identical with the one patented constituted a public use...."

In Smith & Griggs, supra, the Supreme Court held claims 1, 2, 3, 4, and 6 of Sprague patent No. 228,136, and claims 2, 3 and

5 of patent No. 231,199 invalid because of a public use of a machine which was identical with said claims more than two years prior to the application date of December 2, 1878.

But the Court held claims 5 of patent No. 228,136 and claims 1 and 4 of patent No. 231,199 valid and infringed. These claims were directed to improvements which were made within the two-year period. Therefore, the claims which were not identical with the machine in public use were held valid and infringed, even though the Court stated: "These changes, which are apparently not of great importance, perfected the invention, and enabled the inventor to take the final step between partial and complete success." (p. 255)

Therefore, this Court's statement that Smith & Griggs, supra, supports its affirmation of the holder of the lower Court's invalidity of the preformed core strip method claims because of the alleged public use of the flat pack method is entirely contrary to the facts and holding of Smith & Griggs, supra.

Smith & Griggs, Mfg. Co. v. Sprague, actually supports the following analogy:

A. The original Sprague machine claimed in the invalid claims of Sprague may be considered the equivalent of the flat pack method which was allegedly in public use; and

B. The improvements in the machine which were the subject matter of the claims held valid in Smith & Griggs, supra, were the equivalent of the improved nonidentical preformed core strip method defined in the claims of Green,

et al.

Consequently, instead of supporting this Court's position that nonidentical improvements of the preformed core strip method over the flat pack method were invalid because of the alleged public use of the flat pack method, Smith & Griggs, supra, supports appellant's contention that, not having been in public use and being nonidentical, the claims to the preformed core strip method are valid claims.

Additionally, the Supreme Court stated that if the inventor had patented "the entire machine as he ultimately constructed and operated it, considered as a unit" (p. 255), rather than claiming the specific improvements as subcombination claims, the resulting combination claims would be valid despite the public use of certain elements of those claims directed to the earlier machine.

The Supreme Court reasoned that the machine in public use "would have been imperfect, and incomplete and merely experimental, until it had received from its inventor every element necessary to its operation" (p. 255).

The Court made the foregoing holding and statements in spite of the fact that "there was no real effort to keep the use of the machine secret" (Op. 8) and "the alterations made in the machine in question, however useful were not vital to its organization. Without them it could and did work so as to be commercially successful" (Op. 8) and the changes were "apparently not of great importance" (p. 255).

In Smith & Griggs, supra, the Supreme Court concluded that the use of the original, unimproved machine was not experimental,

but it held, further, that the public use of the original machine did not invalidate the claims to the improvements made during the two-year statutory period before the filing of the respective Sprague patent applications.

Further, in Smith & Griggs, supra, while the Supreme Court found that the changes in the Sprague machine "are apparently not of great importance" that they "perfected the invention and enabled the inventor to take the final step between partial and complete success" (p. 255). This is exactly the situation in the present case because the steps defined in the preformed core strip method claims, even if considered to be "not of great importance", perfected the invention.

Therefore, Smith & Griggs, supra, actually supports the following contentions which were made by appellant in regard to the preformed core strip method claims:

1. The sale of a product made by a method not identical with the one patented did not constitute a public use;

2. There is no requirement that experiments be kept secret to avoid the statutory bar; and

3. Minor alterations which perfect a machine or method are patentable despite the public use of the unpatented machine or method.

The Court in Smith & Griggs, supra, held that a sale which is "incident" to the testing of a machine for the purpose of perfecting it, does not destroy the experimental nature of the testing (p. 256).

In the instant case, the fact situation did not, in any way, reflect a long period of commercial public use and sale as it did in

Smith & Griggs, supra. As a matter of fact, there never was a sale of the honeycomb core material manufactured by the preformed core strip method prior to the filing of the Green, et al patent application, nor a public use of the exact method patented, as this Court indicated (Op. 7). Moreover, the five sales of flat pack material, although not subject to a secrecy limitation, were not the result of extensive commercial exploitation as in the case of the first Sprague machine, but were samples of core for experimental use. After the first five sales, a later sale, after the filing of the Green, et al application, involved a piece of core found lying under a workbench, which certainly indicates the lack of commercial activity in the sale of the product.

None of the core made by the flat pack method and sold more than one year prior to the filing date was distributed in the commercial manner of the products of the first machine of Sprague.

Testing continued and numerous changes were made in arriving at the preformed core strip method which differed from and perfected the flat pack method. Only a few pieces of flat pack core were sold before the critical date, for the total price of approximately Six Hundred Dollars ($600.00). Can this be said to be the commercial sale of a product which has for its dominant purpose profit and not experimentation?

Respectfully submitted,

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THOMAS P. MAHONEY
ROBERT D. HORNBAKER

Attorneys for Appellant.

CERTIFICATE

I certify that in my judgment the foregoing Petition for Rehearing is well founded and is not interposed for delay.

I further certify that, in connection with the preparation of said Petition, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the said foregoing Petition is in full compliance with those rules.

/s/ Thomas P. Mahoney

THOMAS P. MAHONEY

NO. 20000

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

NESBERT W. COX and
MARVIN P. McGUIRE,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

See Tales Vol. 3349

APPELLANTS' REPLY BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA
CENTRAL DIVISION

FILED

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NO. 20000

IN THE UNITED STATES COURT OF APPEALS

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NESBERT W. COX and
MARVIN P. McGUIRE,

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APPELLANTS' REPLY BRIEF

APPEAL FROM
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NO. 20000

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

NESBERT W. COX and
MARVIN P. McGUIRE,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANTS' REPLY BRIEF

In reply, appellants will make response only to a limited number of the contentions made by the Government [1/] in its brief, confident that this Court will not regard the lack of response to certain Government contentions as any concession of their validity. Unlike the situation of an appellee's brief, it is of course not the office of a reply brief to answer every argument of the appellee when sufficient answer is embodied in the opening brief.

Neither will appellants attempt to restate the points made in their opening brief. To do so would not only be improper but unnecessary,

1/ As the appellee will be designated herein for convenience.

Other matters of form: Appellants' opening brief will be cited as "A. O. B." followed by appropriate pages; appellee's brief will be cited "Govt. Brief", followed by similar pages. Except where necessary for clarity, reference to the appellants will be made collectively by that word. Record references will be made in the same manner as appellants' opening brief.

since they are already adequately developed. In many instances, the Government has totally failed to meet appellants' contentions and virtually all of the authorities upon which appellants relied have been similarly ignored. In that posture of the case, little more need -- nor can -- be said. This Court can recognize an unanswered contention for what it is.

Reply will be made only in areas where it appears that further comment could be of value to the Court.

The difficulty of reply has been exacerbated by the Government's practice of repeatedly making factual assertions in argument without reference to the pages of the record which support those assertions, and also by its employment of case citations without reference to the pages where the purported holding might be discovered. These failures are not only submitted to be a violation of this Court's rules, 2/ but have also required appellants to search the record in an effort to discover foundation for their opponent's assertions, and to search the cited decisions in an attempt to locate the purported holding. Those searches have, in most instances, proved unsuccessful.

Appellants submit, as a matter worthy of introductory note, the strange fact that, of the authorities upon which the Government relies, a total of two appellate decisions 3/ involve postal offenses. All of the other appellate cases cited deal with entirely different fields of criminal law. While, of course, briefs often cite many cases involving differing offenses on matters of procedure and the like, it does not seem unduly burdensome to require at least some meaningful evaluation of the

2/ Rules 18.2(e) and 18.3.

3/ United States v. Johne, 322 F.2d 267 [Brief, p. 31], and United States v. Ross, 205 F.2d 619 [p. 21].

authorities bearing upon the particular type of prosecution involved. This is believed particularly true in view of the fact that a significant number of the authorities involving postal offenses which the appellants set forth in their opening brief have been totally ignored by the Government. 4/

I

THE GOVERNMENT'S BRIEF MISSTATES CERTAIN MATTERS OF EVIDENCE AND RELIES UPON APPARENT IRRELEVANCIES.

While appellants have neither the desire nor the space in which to dispute each of the matters of purported fact which they deem inappropriate in the Government's brief, their duty to aid this Court in a meaningful analysis of the issues requires at least brief note of certain irrelevancies and inaccuracies.

The initial discussion [Govt. Brief 1 and 2] of a different prosecution of one of the appellants is of obscure materiality. True, appellant

4/ For example, only:

Giraud v. United States (9th Cir., 1965), 348 F.2d 820 [A.O.B. 32 and 60];
United States v. Boese, 46 Fed. 917 [A.O.B. 33-36 and 53];
Naftziger v. United States (8th Cir., 1912), 200 Fed. 494 [A.O.B. 33];
Irwin v. United States (9th Cir., 1964), 338 F.2d 770 [A.O.B. 47];
Ross v. United States (9th Cir., 1939), 103 F.2d 600 [A.O.B. 66-69];
Harris v. United States (5th Cir., 1957), 239 F.2d 612 [A.O.B. 40];
Thomas v. United States (6th Cir., 1959), 262 F.2d 844 [A.O.B. 40];
Roe v. United States (5th Cir., 1961), 287 F.2d 435 [A.O.B. 41 and 58].

McGuire was accused of another purported mailing, but he was acquitted of that charge! Apparently its inclusion is an effort to persuade this Court -- under a theory of "guilt by acquittal" -- that the appellants were "bad men" simply because they were charged, and therefore had some propensity for the commission of crime. It is clearly established that evidence pertaining to such purported propensity will be given no effect by the courts. (Please see A.O.B. 52-53.)

The Government has made a number of assertions of fact, in connection with the confession and motion to suppress, which are either without support in the record, or else directly contrary to the record. Each is patently colored to justify or excuse Agent Hardy's conduct. A few, only, of these will be discussed here. 5/

It is claimed that Hardy "noticed that quite a few envelopes and various other papers were strewn around the room" and that this motivated his further conduct [Govt. Brief 6]. In point of fact his testimony was that he noticed "that there were several papers laying [sic] about the room" [R.T. 19:3-5]. There is a difference, it is submitted, between "several" (the evidence) and "quite a few" (the Government's assertion), but more significantly the reference to envelopes simply does not appear. The appellant McGuire was not indicted for being a messy housekeeper, and it is submitted that the fact that there were several papers scattered through a room hardly constitutes a license to search without warrant.

5/ Space limitations have required the elimination of consideration of other inaccuracies. The ones which are discussed, are not necessarily of any great importance, in appellants' opinion, but they are illustrative and possessed of a potential of misleading. As in the instances not discussed, the Government makes the assertions without specific transcript references.

In discussing the purportedly-uncoerced nature of the confession, the prosecution asserts [Govt. Brief 20] that its voluntary nature is shown by the fact that it was not made until "after McGuire had consulted with his attorney." The Government regrettably failed to make any reference to the point in the record where this purported evidence might be found, but appellants have searched and do find some reference to an attorney. In the course of Hardy's urgings that McGuire come to his office and make a statement, McGuire asserted his desire to consider obtaining counsel, to which Hardy responded only with further urgings [R. T. 33:13-20 6/]. McGuire testified that he got an attorney's name out of the telephone book and phoned him before seeing Hardy at the latter's office and that obscurely-identified attorney said "it was okay to go in" and, evidently, confess. The attorney's first name was not even known [R. T. 189:3-21]. This, it is submitted, is quite a different picture than that which the Government paints of a citizen going in to see his own counsel and consulting with him.

A serious warping of the evidence appears at pages 30-31 of the Government's brief, where it is stated:

> "On September 5, 1963, Exhibits Nos. 1 and 2 are mailed from San Francisco (where appellant Cox lives) and they are found to each contain several photographs with X's on the reverse side, several of which are of two girls together." (Emphasis added.)

Disregarding the lack of any transcript references to support these assertions, and disregarding further the gratuitous observation concerning "two girls together" -- a rather unnecessary endeavor to

6/ See also, concerning McGuire's desire for counsel, R. T. 72: 15-19.

produce prejudice, particularly in view of the stipulation at page 5 of appellants' opening brief -- appellants submit that this is a factual misadventure. Technically, if the words are read in a vacuum, they are sustainable, but when read in the semantic context of the sentence the effect produced is utterly misleading. Exhibits 1 and 2 are opened, cancelled mail envelopes, postmarked at San Francisco September 5, and it is concededly a reasonable inference that they were mailed from that city that date.

But there is absolutely no justification for the succeeding clause that "they are found to contain" several photographs. The clear -- and inaccurate -- implication is that there is evidence that when mailed they contained those photographs, and there is no such evidence. Two weeks after those envelopes were mailed, Agent Hardy found certain photographs and other matter in them; nobody "found" that the contents of those opened envelopes was the same on September 18 as it was on September 5, when they were mailed. By that simple assertion, the Government has sought to blot out thirteen days, during which all sorts of matters may have been removed from or placed inside those opened envelopes.

II
THE GOVERNMENT HAS FAILED TO MEET ITS BURDENS CONCERNING THE SEIZURE AND CONFESSION, AND TO OVERCOME THEIR CONSTITUTIONAL INTOLERABILITY.

A. THE EFFECT OF THE OVERREACHING AND COERCION FOUND TO BE PRESENT IS NOT AMELIORATED BY THE ADDITIONAL FACT THAT A DETAIL OF APPELLANT McGUIRE'S TESTIMONY WAS DISBELIEVED.

The Government contends [Govt. Brief 19] that the trial court found the necessary "clear and convincing" evidence of consent (please

see A. O. B. 21-22) and accuses the appellants of making an incomplete statement of the actual finding of the trial judge. If that were so, it would be a serious matter, but it is not true.

The Court will recall that in their opening brief [pages 19 and 20], appellants noted the trial court's conclusion that both "overreaching and coercion" had been practiced, but that it nevertheless found consent because of disbelief of McGuire's version as to one detail of the events of the search. Appellants argued that disbelief as to the detail did not, in law, supply the requisite affirmative showing of consent. The Government has not only completely ignored that argument, but in the course of its own criticism of the appellants terminates its extract from the trial court's comments immediately before the discussion of that disbelieved detail. Appellants submit that this, in itself, is a tacit admission of the point urged. Continuing beyond the prosecution's ellipses, the trial court's statement, following its conclusion that there were elements of truth in McGuire's version and that there had been overreaching and coercion, was:

> "It is my final conclusion that I cannot accept the version as given by Mr. McGuire [at this point the Government discontinues quoting], and there are two or three matters, two or three rather key circumstances that have led me to believe that, or have led me to that conclusion, I should say.
>
> "Firstly, I do not believe under the circumstances that Mr. Hardy came up to the door as Mr. McGuire testified. Mr. McGuire stated that Mr. Hardy was parked fifty or sixty feet behind him and he stayed in his car for a little while and he was out working on his car, and as he leaned over and looked into it

Mr. Hardy rushed across the driveway, ran up to the door and pounded on it.

"Now, I don't know just how far the door was away, or the distance from the street up to the door, but however far it was it seems to me that it would have been difficult for Mr. McGuire to have been looking down and bending over and at the same time observe what Mr. Hardy was doing, and also possibly difficult to hear at that distance just what was stated, if he shouted. That is a procedure I think that would be quite uncommon for a law enforcement officer such as a postal inspector.

"Now, that to me does not ring true, Mr. McGuire's statement as to that." [256:24-257:21] (emphasis added).

The trial court may well have been entirely justified in believing Hardy's version as to how he approached the doorway. Nevertheless, that disbelief clearly fails to supply clear and convincing proof of consent to everything that occurred thereafter.

B. THE GOVERNMENT RELIES ON INAPPOSITE AUTHORITIES, REFUTED BY A RECENT HOLDING OF THIS COURT.

Appellants are somewhat baffled at the authorities upon which the Government relies as justifying the search and seizure. Primary reliance is placed upon Ellison v. United States (D. C. Cir., 1953), 206 F. 2d 476, 478. There, it was held that an officer who stands at the door of a premises and observes through the doorway "the fruits of crime -- or what he has good reason to believe to be the fruits of crime" (in that case the recently-stolen goods), has probable cause to search. If the fact that a room contains several papers lying around constitutes

good cause to believe that those papers are the fruits of a crime -- or even if the presence of cancelled envelopes constitutes good cause to believe they are involved in postal violations -- then there will be scarcely any household in this nation which is not subject to indiscriminate search by the postal authorities. The situation is so remote from that at bar as to approach the utterly irrelevant. 7/

The Government also asserts the authority of this Court's decision in Polk v. United States, 314 F. 2d 837. 8/ Polk was a per curiam affirmance based upon the trial court's finding that there had been no entry onto the defendant's premises. It followed an earlier appeal in the same case in which this Court (291 F. 2d 230) reversed for a determination as to whether the officers made their observations while within the defendant's premises or from a public area. The affirmance in the second Polk case was based upon the factual finding that the latter was true. In the case at bar, no one has even suggested that Hardy's observations were not made while he was within the appellant McGuire's home. One is hard put, therefore, to understand the basis for reliance on Polk.

Probably the decision most destructive of the Government's

7/ The propriety of the Government's reliance on Ellison is also negated by significant decisions of courts of appeal distinguishing Ellison in a manner virtually identical to the distinction here. See for example:

Hobson v. United States (8th Cir., 1955), 226 F. 2d 890, 894;

Work v. United States (D. C. Cir. [the same court which decided Ellison], 1957), 243 F. 2d 660, 662 (pointing out that in Ellison "the evidence sought to be suppressed was secured before entry was made.").

8/ Cited by the Government as "Poke".

position is the recent holding of this Court in Cipres v. United States, 343 F. 2d 95.

There, the trial court expressly stated that it believed the evidence of the officers involved and therefore found as a fact that the defendant had told the officers they might make the search. (In the case at bar, of course, the trial court made no such finding, but merely found that some details of McGuire's testimony were not credible, thereupon concluding that there was consent notwithstanding the over-reaching and coercion; it is submitted that this is a much weaker finding than that involved in Cipres.) On appeal, this Court reversed, holding that the issue was much broader than merely a simple finding as to whether there was "verbal assent", and holding that this issue could not be resolved by a mere weighing of credibility as between the defendant and the officers. 343 F. 2d at 97.

> "Waiver, in this context, means the 'intentional relinquishment of a known right of privilege.' [citation] Such a waiver cannot be conclusively presumed from a verbal expression of assent. The court must determine from all the circumstances whether the verbal assent reflected an understanding, uncoerced and unequivocal election to grant the officers a license which the person knows may be freely and effectively withheld. We recently sustained a district court finding that such waiver was lacking despite an express verbal consent, and such cases are common. They rest not only upon the nature of the waiver itself, but also upon a recognition that the purpose of the exclusionary rule is not only to discourage overreaching by police officers, but also, and primarily, to protect the rights

of the citizen. The crucial question is whether the citizen truly consented to the search, not whether it was reasonable for the officers to suppose that he did."

"A number of circumstances suggest that [the defendants'] assent may have reflected less than a free, deliberate, and unequivocal decision to permit the officers to open the luggage: It was attained 'under color of the badge' and was therefore presumptively coerced."

343 F. 2d at 97-98 (emphasis added).

Here, even if one accepts the Government's thesis that a verbal consent was finally given after Agent Hardy's numerous "fruitless efforts" to obtain the consent, there is no question that there was overreaching nor that the consent was infected by actual, as well as presumptive, coercion. This Court there also noted, as indicative of lack of waiver, certain factors which are present here, such as the fact that the verbal consent was given only after it had been previously withheld and that it was accompanied by protestations of innocence.

C. SUPREME COURT DECISIONS UPON WHICH THE GOVERNMENT RELIES ARE ACTUALLY DESTRUCTIVE OF THE GOVERNMENT'S POSITION.

Finally, the employment of three recent decisions of the Supreme Court in support of the proposition that McGuire was "acting 'with a rational intellect and a free will' " [Govt. Brief 21] is incomprehensible. In each of those decisions, confessions were held inadmissible for

significant reasons. 9/ Each of those decisions actually appears to be the diametric opposite of the point for which it is cited.

III
THE GOVERNMENT HAS TOTALLY FAILED TO MEET THE CONTENTIONS OF INSUFFICIENCY OF THE EVIDENCE.

A. THE FAILURE TO ESTABLISH COX'S IDENTITY IS SUBSTANTIALLY CONCEDED, AND THE CIRCUMSTANTIAL "EVIDENCE" OF GUILT IS INSUBSTANTIAL ON ITS FACE.

The Government has failed to make even an effort at showing that appellant Nesbert Cox and the Ned Cox who was implicated were one and the same person; on appeal as at the trial, the Government has satisfied itself with the proposition that a denial of identity is evidence of identity. The untenable nature of this has already been shown [A. O. B. 57-61].

Beyond this "guilt by denial" argument, the Government relies

9/ Reck v. Page, 367 U.S. 433, 440-1, 444, 81 S. Ct. 1541, 6 L. Ed. 2d 948 (re circumstances other than physical coercion);

Spano v. New York, 360 U.S. 315, 321-2, 324, 79 S. Ct. 1202, 3 L. Ed. 2d 1265.

The most significant of the three decisions, however, is the unanimous decision in Blackburn v. Alabama, 361 U.S. 199, 80 S. Ct. 274, 4 L. Ed. 2d 242. In that case, several circumstances highly pertinent to the confession involved here were also present and noted to be significant, including:

1. A history of mental illness and hospitalization (361 U.S. 200-202);

2. The fact that the police officer had composed the statement in narrative form, for the signature of the accused, the practice followed by Agent Hardy here (361 U.S. at 204); and

3. The factor of any history of emotional instability or mental illness, even if not reaching the point of psychosis (361 U.S. at 208).

upon a misstated claim of a finding as to the contents of certain mailings (see §I, supra), and the facts that certain of the seized matters were printed and that Cox worked in a print shop. This is the sum total of the admittedly-circumstantial "proof" of Cox's guilt. To elaborate on its utter inadequacy would be lilly-gilding.

B. THE ATTEMPTED DISTINCTION OF THE JOHNE CASE IS UNTENABLE.

The Government seeks to distinguish the highly compelling decision in United States v. Johne (7th Cir., 1963), 322 F. 2d 265 [see A.O.B. 33 and, particularly, 52-53]. The sole distinction urged is that, while evidence of intent is not sufficient to show the commission of crime, evidence of planning does constitute affirmative evidence that the plans were carried out [Govt. Brief 31]. That distinction is too fine for appellants' comprehension. If evidence that a person intends to do an act is insufficient to sustain a finding that he did it, it is difficult to understand why evidence that he was planning to do the act is any more evidentiary of its execution.

C. IN VIEW OF THE FAILURE OF PROOF AS TO COX, THERE IS A FAILURE AS TO McGUIRE AND THE GOVERNMENT'S ATTEMPT TO AVOID THIS BY A CHANGE OF POSITION ON APPEAL IS PROHIBITED.

1. IN THE ABSENCE OF SUBSTANTIAL EVIDENCE CONCERNING A GUILTY PRINCIPAL NAMED IN THE INDICTMENT, THERE HAS BEEN A FAILURE OF PROOF AS TO McGUIRE AS HIS PURPORTED AIDER AND ABETTOR.

With the Government's tacit admission of lack of identification

of the appellant Cox, the contentions noted in the opening brief concerning the deficiency of proof that the appellant McGuire aided the appellant Cox appears inescapable. McGuire was indicted for aiding Nesbert W. Cox, and cannot be convicted by evidence relating to any activities of someone who is not shown to be Nesbert W. Cox.

The Government's answer is the argument that, since a person may be convicted of aiding and abetting one who is neither charged nor convicted, nor even identified, McGuire's conviction may be affirmed on the ground that he aided and abetted "someone".

It is submitted that this argument is untenable. The law requires a guilty principal before the alleged accomplice may be convicted.

Shuttlesworth v. City of Birmingham, 373 U.S. 262, 265-266, 83 S.Ct. 1130, 10 L.Ed.2d 335. 10/

This requirement is not satisfied by evidence, such as that relied upon here, that the accused accomplice performed acts which might conceivably have been of assistance to some "principal", without any evidence of the commission of a crime by that alleged-but-unknown principal. The Government could prove to the nth degree, as it urges here [Govt. Brief 28], that McGuire corresponded with "someone", thanked "someone" and the like, but that does not prove that "someone" committed a postal offense as charged nor that these acts were in aid of any guilty act.

10/ Approving, among many other decisions, a number of authorities cited by appellants here and in their opening brief, including:

Karrell v. United States (9th Cir., 1950), 181 F.2d 981 [A.O.B. 61];

Edwards v. United States (5th Cir., 1961), 286 F.2d 681 [A.O.B. 62].

In a most persuasive case, it was held, in reversing a conviction as aider and abettor, that it is obvious that there can be no conviction for aiding and abetting unless there is satisfactory evidence of two elements: 1) his participation, and 2) that there was a principal for whom he was acting, which principal was guilty of the offense.

United States v. Horton (7th Cir., 1950),

180 F. 2d 427, 431.

The court noted:

> "The situation is no different than if Kile [the supposed principal] had been tried with Horton and there had been a failure of proof as to Kile. Then there would have been a failure of proof as to the commission of an offense by Kile and consequently Horton could not have been convicted as an aider and abettor." 180 F. 2d at 431.

The hypothetical situation proposed there is a precise characterization of the posture of the case at bar.

2. THE GOVERNMENT'S NEW CONTENTION ON APPEAL, REPUDIATING THE INDICTMENT FOR AIDING NESBERT W. COX, IS IMPROPER AND SELF-ILLUSTRATIVE OF A FATAL VARIANCE.

Faced with these insuperable difficulties, the Government has made a 13th-hour change of position on appeal, now arguing that McGuire was not tried or convicted as an accomplice of Nesbert W. Cox. This argument proves too much.

McGuire was not indicted for aiding and abetting "someone", nor a person unknown, nor anything of the sort. He was indicted for aiding and abetting a specified person: Nesbert W. Cox [C. T. 2:19-28,

3:3-12]. The Government now says in its brief: Okay, he didn't aid and abet Nesbert W. Cox; he aided and abetted "someone" and that's what he was convicted of.

This assertion is disingenuous. It is inconceivable that the grand jury had in mind aiding and abetting "someone" else, when it indicted for aiding and abetting Nesbert W. Cox. It is inconceivable that an indictment charging McGuire with aiding Nesbert W. Cox sufficiently advised him that he should prepare his defense to the charge of aiding "someone" else. It is inconceivable that the trial court found McGuire guilty of aiding and abetting "someone" else, rather than Nesbert W. Cox.

But, giving this afterthought theory of the Government its weight, it clearly and unavoidably discloses a fatal variance. Exhaustive research has not disclosed any appellate decision which passed, one way or another, on the question of a variance in a prosecution for aiding and abetting where the charge was aiding one person and the proof related to aiding another. To that extent, this appears to be a question of first impression, but the reason would seem apparent: Unlike the ordinary substantive offense, the question of identity (or at least existence) of the principal is all-important in the prosecution of a purported accomplice, and it never seems to have been seriously urged otherwise.

This case is totally unlike the decision of this Court in Ferrari v. United States (9th Cir., 1948), 169 F.2d 353, 354. There, the defendant was charged with receiving heroin from one Bruno, while the evidence showed receipt from one Flier. This Court held that a variance was obviously present, but non-prejudicial because the defense

was entirely one of alibi and therefore identity could not affect the preparation of the defense. This distinguishing element -- which is of course not present here -- was subsequently recognized in a case in which there was the same variance but misidentification was held prejudicial, and the judgment reversed, because there was no way to prepare a defense concerning a transaction with a person not identified in the indictment.

Hallman v. United States (D.C. Cir., 1953),
208 F.2d 825, 826, 827.

Tangential but persuasive authority for the proposition that variance on the matter of identity is prejudicial, where the case involves the relationship of persons, appears from the reversal of a conviction by this Court, on the ground of variance, in the highly-analogous context of a conspiracy prosecution.

Rocha v. United States (9th Cir., 1961), 288 F.2d 545,
553, certiorari denied 366 U.S. 948.

The fatal effect of this shift of position by the Government on appeal may be illustrated in another way. If McGuire had not been indicted for aiding Nesbert W. Cox, but rather for aiding the latterly-conceived "someone", there would have been totally improper joinder, and both appellants would have been entitled to a severance.

Ingram v. United States (4th Cir., 1959),
272 F.2d 567, 570-578.

No attack on the joinder was made in the case at bar, of course, but this was for a perfectly obvious reason: both appellants believed the charges to be as stated in the indictment, that McGuire aided Nesbert W. Cox, not that McGuire aided "someone".

D. A RECENT POSTAL-OFFENSE DECISION CONCERNING THE INSUFFICIENCY OF EVIDENCE OF MERE PROBABILITY IS OF PERSUASIVE INTEREST HERE.

Since the filing of their opening brief, appellants have discovered a recent and highly persuasive decision in which a conviction for postal offense was reversed on appeal. While the case involved mail fraud, the pivotal issue there (and equally involved here) was whether there had in fact been a use of the mails for the purpose alleged.

United States v. Ellicott (4th Cir., 1964),
336 F. 2d 868.

While recognizing the limitations on the power of the appellate court and also the great weight to be given the findings of the district judge, sitting (as here) without a jury, to determine the facts, the appellate court nevertheless held that where the evidence does not reach the level of the substantial on that issue, it becomes a question of law, since no crime has then been made out. 336 F. 2d at 871.

There was extensive evidence described in the opinion concerning practices of the defendants and their employees in handling mail, metering prospective mailings and the like, but the court held:

> "At most the evidence proved no more than a probability of the use of the mails. Principally, reliance is put on a customary practice in the Charter Department, for no one states Jones mailed the letter. Thus the government depends merely upon an inference from conventional procedure: that if the Department usually noted deliveries in a distinctive way, then it did so in this specific instance. But this is only a

probability which, however great, cannot convict. . . . While we are sensible to the difficulties of reconstructing one of myriad postal events, nevertheless when, as here, the prosecution makes it the vital nexus of the accused to the crime it assumes and must surmount this difficulty."

336 F. 2d at 870-871.

The court continued on to note, as to one defendant, that the statements of co-defendants were required to be disregarded and that once these were put aside:

"Only a practice or custom of mailing is left, proving nothing more than a probability, upon which a judgment beyond a reasonable doubt cannot rest. No one testified to an actual mailing."

336 F. 2d at 872 (emphasis added).

That case is virtually four-square with the case at bar. Here, there is no doubt that the appellants did, at some time, use the mails, as did the appellants in that case, and as do an overwhelming majority of the citizens of this country. But, taken at best, there is no more than a possibility -- or even, conceivably, although one doubts it, a probability -- that a mailing of the matter which is the res of this prosecution ever occurred, to say nothing of occurring at the time or times (whichever it is) charged in the indictment and between the persons charged.

Respectfully submitted,

EDWARD L. LASCHER

Attorney for Appellants

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Edward L. Lascher

EDWARD L. LASCHER

No. 20,003

IN THE

United States Court of Appeals

For the Ninth Circuit

LEON SLAVITT,
Plaintiff-Appellant,

vs.

GILBERT KAUHI, ABRAHAM KAPANA, and SPENCECLIFF CORPORATION, LTD.,
Defendants-Appellees.

Upon Appeal from the United States District Court for the District of Hawaii

ANSWERING BRIEF ON BEHALF OF GILBERT KAUHI, ABRAHAM KAPANA, AND SPENCECLIFF CORPORATION, APPELLEES

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ANSWERING BRIEF ON BEHALF OF GILBERT KAUHI, ABRAHAM KAPANA, AND SPENCECLIFF CORPORATION, APPELLEES

JURISDICTION

Jurisdiction of the District Court was based upon 28 U.S.C. Sec. 1332. The jurisdiction of this Court is founded on 28 U.S.C. Secs. 1291 and 1294.

Judgment below was entered on December 8, 1964, (R. 132). Appellant's motion for new trial and for judgment notwithstanding the verdict filed on December 9, 1964 (R. 132), was denied on December 29, 1964 (R. 140). Notice of appeal was filed on January 20, 1965 (R. 142).

STATEMENT OF THE CASE

The incident in question occurred in the early hours of September 23, 1960, at the Barefoot Bar in Honolulu. Appellant arrived at the bar around 1:00 to 1:30 A.M., with Miss Rhoades, an airline stewardess (Tr. 113). Prior to his arrival he had enjoyed a scotch and soda, a glass of wine and two mai-tais.[1]

At the bar appellant consumed a third mai-tai and part of a fourth (Tr. 112-114).

After the floor show, appellant was requested to finish his drink by an unidentified man (Tr. 114-115). He protested and claimed that he was then bodily carried to the exit at the head of the stairs and thrown through the air to the first landing (Tr. 116) about 6 steps below (Tr. 68).

Mr. Kauhi, employed by Spencecliff Corporation, Ltd., as a doorman (Tr. 64), testified that he had approached appellant near closing time and asked him to finish his drink (Tr. 76, 77). Appellant objected so Mr. Kauhi notified the assistant manager, Mr. Kapana (Tr. 78). Mr. Kapana talked with appellant and then asked Mr. Kauhi to call the police (Tr. 83). While completing the call downstairs, Mr. Kauhi heard a "boom-boom-boom" noise. Running up the stairs, he saw plaintiff seated on the landing (Tr. 98, 101).

Mr. Kapana, the assistant manager, testified he went to appellant's table near closing time and asked him to finish his drink (Tr. 262). Appellant became angry and abusive and threatened to have Mr. Kapana

[1]A mai-tai contains about 2 oz. of rum (Tr. 195).

fired (Tr. 264) and finally took a swing at Mr. Kapana (Tr. 265). After that, appellant was told he must leave (Tr. 265) and was escorted by Mr. Kapana to the exit (Tr. 267). Mr. Kapana then returned to the table to help Miss Rhoades (Tr. 280, 282), leaving appellant standing at the head of the stairs (Tr. 280).

As Mr. Kapana was returning to the table, he heard a thud like some object had fallen on the steps (Tr. 282). He returned to the stairs and saw appellant sitting on the landing (Tr. 283).

QUESTIONS PRESENTED

1. Did the Court abuse its discretion in prohibiting an amendment which contradicted the issues tried by appellant and which was without foundation in law?

2. Was it prejudicial error to refuse instructions detrimental to appellant or to give instructions which correctly set forth the issues or the law?

3. Did the Court abuse its discretion in regulating final argument?

SUMMARY OF ARGUMENT

Appellant contended throughout trial that, although sober and peaceful, he was summarily carried to the stairs and thrown from the bar by appellee Kapana. At the end of the trial, he attempted by amendment to also claim that he was negligently abandoned at the head of the stairs in a drunken condition and allowed

to fall. The latter theory not only surprised the Court and conflicted with the agreed issues but is in disregard of the common law rule imposing no liability on vendors for injuries received by intoxicated patrons.

Appellant also complains of a refusal to give his instructions when they would only have confused the jury and added to his burden of proof. In addition, he ignores the acknowledged purpose of several instructions and the only possible construction given them by the jury.

Appellant's final contentions relate to argument but fail to demonstrate that he either properly objected to any inadequacy of the court's supervision of argument or that the court abused its discretion in allowing a comment on the lack of testimony by his companion, Miss Rhoades.

ARGUMENT

I

APPELLANT'S THEORY THAT HE WAS ENTITLED TO BE GUARDED AGAINST INJURY DUE TO HIS OWN INTOXICATION IS WITHOUT FOUNDATION.

The testimony presented two sharply conflicting versions of the accident. Appellant strongly insisted that he was bodily thrown down the stairs (Tr. 115-116).

Appellees, on the other hand, presented evidence that appellant had become abusive, was escorted to the exit (Tr. 265-267), and thereafter fell while descending the stairs alone (Tr. 336-337).

Although the pre-trial order and evidence at trial produced only these two distinctly opposite positions, much of appellant's brief is devoted to his belated attempt and the court's refusal to force a third theory before the jury.

Appellant contends that once appellees sold appellant a drink they thereafter had a duty to safeguard his welfare and could be found negligent if they allowed appellant to exit and negotiate the stairway on his own (Tr. 377, 400, 406; Op. Br. Argument I & IV; Instruction P-13, R. 58, P-22, R. 67).

The basic fallacy of appellant's position is that the purported duty does not exist. At common law, it is thoroughly established that a vendor of liquor has no liability to the consumer for injuries incurred as a result of the latter's intoxication.[2]

In *Hitson v. Dwyer,* 61 Cal. App. 2d 803, 143 P.2d 952 (1943), plaintiff sued for injuries received when defendants served him liquor while he was obviously in an intoxicated condition. As a result he fell from a bar stool to the floor. The court dismissed the case, stating:

> From our examination of the numerous cases cited we find none which hold, in the absence of a statutory enactment to the contrary, that the sale of intoxicating liquor was the proximate cause of injuries subsequently received by the purchaser because of the intoxication. Rather we find the

[2]Hawaii, by statute, has adopted the common law. "The common law of England, as ascertained by English and American decisions, is declared to be the common law of the Territory of of Hawaii. . . ." Sec. 1-1, Revised Laws of Hawaii, 1955.

> general rule to be . . . : 'The common law gave no remedy for the sale of liquor, either on the theory that it was a direct wrong or on the ground that it was negligence which would impose a legal liability on the seller for damages resulting from intoxication'. (p. 955)

Malone v. Lambrecht, 305 Mich. 58, 8 N.W. 2d 910 (1943), involves an application of the common law rule to a factual situation quite similar to appellant's present claim. There plaintiff drank liquor in defendant's establishment and became intoxicated. Defendant, nevertheless, continued to serve him more. While intoxicated, plaintiff was directed to a basement washroom by defendant and allowed to proceed unescorted. In doing so, he fell down the stairway and was injured.

Although Michigan had both a dramshop act and a statute making the sale of liquor to an intoxicated person unlawful, the dismissal of the complaint was affirmed.[3]

In *Cole v. Rush,* 45 Cal. 2d 345, 289 P.2d 450 (1955), the rule was again followed although defendants had been warned in advance by the plaintiff widow not to serve her husband because he, although normally quiet, became quarrelsome when intoxicated.

[3]Hawaii does not have a dramshop statute. The statute forbidding sale of liquor to an intoxicated person (Op. Br. 49, 54) does not have any bearing herein since there is no evidence appellant was inebriated when served by appellee and the statute does not purport to change the common law rule or establish a civil right of action. See: *Moyer v. Lo Jim Cafe, Inc.,* infra; *Noonan v. Galick, infra; Elder v. Fisher,* 205 N.E. 2d 235 (Ind. 1965); *Knierim v. Izzo,* 22 Ill. 2d 73, 174 N.E. 2d 157 (1961).

The court in *Noonan v. Galick,* 19 Conn. 308, 112 A. 2d 892 (1955), denied recovery to an intoxicated woman who was struck by an automobile while lying in the street. The court held the vendor not liable, stating:

> There is abundant authority for the proposition that no remedy exists against the dispenser of liquor for injuries and damage resulting from the acts of an intoxicated person except to the extent provided by statute. . . .
>
> If there is no remedy at common law against the seller in favor of one injured by the purchaser of liquor, certainly there can be none in favor of the intoxicated person itself. (p. 894)

In *Moyer v. Lo Jim Cafe, Inc.,* 19 App. Div. 2d 523, 240 N.Y.S. 2d 277 (1963), the court dismissed a complaint claiming damages for injuries received as the result of a fall while intoxicated, and stated flatly that:

> There was no special duty resting upon defendant to protect plaintiff from the results of her voluntary intoxication. (p. 279)

See also:

Megge v. United States, 344 F. 2d 31 (6th Cir. 1965);

Cherbonnier v. Rafalovich, 88 F. Supp. 900 (D. Alaska 1950);

48 C.J.S., *Intoxicating Liquors,* Sec. 430;

30 Am. Jur., *Intoxicating Liquors,* Secs. 523, 524;

54 A.L.R. 2d 1152.

The second fallacy of appellant's present position is that it conflicts directly with his own testimony at trail and his agreed pre-trial theory of the case.

In the pre-trial order, appellant stated as his theory of recovery, that he was "negligently or intentionally pushed or thrown down the stairs . . ." (R. 29).

In his opening argument, counsel for appellant promised that the evidence would show that a man "picked him up out of that chair bodily, walked to the stairway . . . and threw the plaintiff down the stairway . . ." (Tr. 5-6).

At trial, appellant testified that he was bodily thrown down the stairs (Tr. 116).

Not once during the entire course of the case did appellant claim that he fell due to intoxication or that he was in fact intoxicated. Rather he flatly denied this in his testimony, stating that the drinks had no effect on him. He was not slurring his speech and was not unsteady in his gait (Tr. 159).

Under these circumstances, it is understandable that both counsel for appellees and the trial court were surprised when appellant's counsel attempted to assert liability for negligently failing to protect appellant from possible injury due to his own intoxication.

The court properly recognized that appellant's new theory went beyond the issues tried in the case (Tr. 390-391).

It is the duty of the trial court to determine whether an issue not pleaded has been tried by the parties. *Chesapeake & Ohio Ry. v. Newman,* 243 F. 2d

804, 812 (6th Cir. 1957). If the court finds, as was done here, that the issue was not so tried, Rule 15(b), is not applicable. *Sears Roebuck & Co. v. Marhenke,* 121 F. 2d 598 (9th Cir. 1941).

It is then properly within the court's discretion to deny an attempted amendment and limit the jury's consideration to the theories and evidence presented at trial. *Hargrave v. Wellman,* 276 F. 2d 948 (9th Cir. 1960); *Young v. Johnson,* 286 F. 2d 365 (10th Cir. 1960); Cf: *United States v. 47 Bottles,* 320 F. 2d 564 (3rd Cir. 1963).

ARGUMENT

II

THE COURT DID NOT ERR IN GIVING OR FAILING TO GIVE INSTRUCTIONS.

A. Appellant cannot complaint of a failure to give instructions detrimental to his position or ask review of instructions given without objection.

Under Court's instruction number 18, the jury was informed that appellant could recover if Mr. Kapana threw him down the stairs causing him injury (R. 110, Tr. 495).

Appellant contends that this instruction was unduly limiting and that the jury should also have been given definitions of assault and battery (Instruction P-11) and negligence (Instruction P-22) (Op. Br. pp. 50 and 57).

There is no question that, if appellant's testimony was believed, he suffered an assault or that, in the

pre-trial order, he claimed to have been negligently thrown down the stairs.

Appellant, however, fails to recognize that under the court's instruction it was immaterial whether Mr. Kapana's purported actions were negligent or non-negligent or whether Mr. Kapana had committed an assault *and* also had manhandled appellant. The jury was free to ignore these technical preliminary matters and hold appellees liable if they simply found appellant had been thrown down the stairs.

Contrary to appellant's belief, his burden would have been increased if his instructions on assault or negligence had been given, for the jury would then have plainly been told that appellant had the burden of proving not only that he had been thrown but *also* that the act was either negligent or an intentional assault and battery.

It is obviously not the duty of a court to give instructions which confuse rather than assist the jury and if the instructions given adequately cover the issues, no further instructions are necessary. *Southern Pac. Co. v. Souza,* 179 F. 2d 691, 694 (9th Cir. 1950); *Estate of Ching,* 46 Hawaii 127 (1962).

Nor can a party complain of a refusal to give instructions which operates to his benefit. Cf: *Tabor v. Hahs,* 398 S.W. 2d 7 (Mo. App. 1965); *Brockie v. Shadwick,* 396 S.W. 2d 63 (Ky. App. 1965); *Painter v. State Dept. of Roads,* 177 Neb. 905, 131 N.W. 2d 587 (1964).

Appellant further complains that Court's instruction number 18 allowed recovery only if he was bodily

thrown down the stairs and would prevent the jury from considering whether he was pushed or shoved (Op. Br. p. 60).

Again appellant must recall that in all of the testimony favoring recovery, there is no mention that he was pushed, tripped or shoved. Any finding to this effect would have been pure speculation and any instruction on this point would have been unsupported by any evidence and erroneous. *Teegarden v. Dahl,* 138 N.W. 2d 668, 677, (N.D. 1965); *Salinas v. Kahn,* 2 Ariz. App. 181, 407, P. 2d 120, 130 (1965).

Nor did appellant properly object to this instruction as modified. When the court originally read the instruction to counsel, appellant did object and suggest a change (Tr. 405-407). The court then modified the instruction to eliminate the statement about appellant being carried to the stairway, in accordance with appellant's request. After the modification appellant said nothing (Tr. 407).

Both Rule 51, F.R.C.P. and the decisions of this Court prohibit appellant from remaining silent when an objection could have benefited the trial court and then complaining of error on appeal. *Crespo v. Fireman's Fund Ind. Co.,* 318 F. 2d 174 (9th Cir. 1963); *Cosper v. Southern Pac. Co.,* 298 F. 2d 102 (9th Cir. 1961).

B. Defendants' Instructions Nos. 2 and 3 were not erroneous.

Appellant argues that the court erroneously instructed the jury that contributory negligence in the form of willful intoxication would bar any recovery (Op. Br. 45).

The record affirmatively shows that appellant is mistaken both in his reading and interpretation of the instruction.

All references to negligence or contributory negligence were voluntarily withdrawn from instruction D-2 when appellant's negligence theory was disallowed (Tr. 391, 392).

Nor was the instruction presented on a contributory negligence basis. It was merely a statement of appellee's contention. The jury was not told that intoxication which proximately contributed to the accident in any degree would bar recovery even though they found that appellant had been thrown down the stairs.

On the contrary, both counsel emphasized to the jury in argument that there were two basic and conflicting versions of the incident in evidence. Either appellant was thrown or he fell without fault of appellees. One version resulted in liability and the other a verdict for appellees and it was the jury's prerogative to accept either one (Tr. 410, 411, 430, 432 and 445).

Niether counsel nor the court argued or implied that the jury could adopt *both* positions or that acceptance of both would bar recovery as would an ordinary finding of negligence and contributory negligence.

It is, of course, proper for the court to instruct the jury as to the theories of the parties, 88 C.J.S. *Trial,* Sec. 275 and appellant cannot complain if such an instruction could not mislead the jury. Cf: *Meissner*

v. Papas, 124 F.2d 720, 724 (7th Cir. 1941); *O'Brien v. Great Northern Ry.,* 145 Mt. 13, 400 P.2d 634 (1965); *Phoenix Mut. Life Ins. v. Harmegnies,* 110 F.2d 20, 26 (8th Cir. 1940).

Similarly instruction number D-3 stating the statutory duty of liquor licensees, had a very limited application and could not have resulted in jury confusion. There was evidence that appellant had become argumentative and profane and was asked to leave (Tr. 262, 263). Thereafter he was physically escorted to the exit (Tr. 267).

The instruction was necessary to inform the jury that appellees had a statutory right and obligation to escort a patron of appellant's demeanor away from the bar. Otherwise the jury could well have believed that when appellant was led by the arm to the stairs a battery had been committed and recovery was in order.

This was carefully explained to the jury in argument and no reference was made indicating that the statute would be any defense to liability for throwing appellant down the stairs (Tr. 456-458).

A charge is not erroneous simply because it sets forth a statutory provision in an abstract manner, particularly where there is no danger of misleading the jury. *City of Montgomery v. Jones,* 277 Ala. 617, 173 So. 2d 781 (1965).

If appellant felt that the jury might extend the statute and believe it afforded a defense to his claim of being thrown down the stairs, he was free to offer

an explanatory instruction stating that unreasonable force could not be asserted, as he now states in his argument (Op. Br. 52). Not having done so, his present complaints are ill founded. *City of Montgomery v. Jones,* supra; *Shepard v. Harris,* 329 S.W. 2d 1 (Mo. 1959).

ARGUMENT

III

APPELLEES' ARGUMENT WAS NOT IMPROPER NOR DID THE TRIAL COURT ABUSE ITS DISCRETION IN REGULATING THE ARGUMENT OF COUNSEL.

Limitation or regulation of argument lies within the broad discretion of the trial judge. *Twachtman v. Connelly,* 106 F.2d 501 (6th Cir. 1939). A trial court's determination of whether an argument is improper will not be reviewed unless the discretion of the court is clearly abused. *Braman v. Wiley,* 119 F.2d 991 (7th Cir. 1941); *Maryland Cas. Co. v. Reid,* 76 F.2d 30 (5th Cir. 1935).

Appellant objected to appellees' argument concerning the testimony of Officer Lapilio (Op. Br. 61) despite the fact that appellant testified as to his conversation with the officer (Tr. 119) and counsel for appellant mentioned appellant's statement to the officer in final argument (Tr. 422).

The argument, in context, does not appear to prejudice appellant (Tr. 452). However, the court sustained the objection and instructed the jury to disregard that portion of the argument (Tr. 492).

Appellant did not challenge the sufficiency of the court's admonition or offer further objection (Tr. 492, 505). His present claim that this admonition was inadequate is too late to be of assistance to the trial court or to form grounds for review herein. *Shepard v. Harris,* supra; Cf: *Quam v. Wengert,* 86 N.W. 2d 741 (1957).

Similarly, allowing appellees to refer to appellant's failure to call Miss Rhoades as a witness was not erroneous or an abuse of discretion.

Miss Rhoades admittedly must have had knowledge of the incident (R. 116), was a member of appellant's crew (R. 111, 112), and worked for appellant's employers both at the time of the incident (R. 111), and in the year of trial (R. 169). Appellant testified that he knew her address as late as three and one-half years after the incident (R. 168, 169). This testimony, of course, does not entirely agree with the comments made by appellant's counsel (Op. Br. 65). However, the evidence was certainly sufficient for the court to conclude that Miss Rhoades was a friend of appellant. Cf: *Claybrook v. Acreman,* 373 S.W. 2d 287 (Tex. App. 1963), and that she was available and her address known to appellant for a sufficient period of time to allow him to depose her.

A proper inference was therefore raised by the lack of any deposition and the court did not abuse its discretion in allowing counsel to so comment in argument. See: *Abel v. Yoken,* 104 N.H. 119, 179 A.2d 456 (1962); *Kierce v. Central Vt. Ry.,* 79 F.2d 198 (2nd Cir. 1935); *Williamson v. Feinstein,* 311 Mass. 322, 41

N.E. 2d 185 (1942); *Chesapeake & Ohio Ry. v. Richardson,* 116 F.2d 860 (6th Cir. 1941).

CONCLUSION

Appellant's entire approach to the issues before this Court involves a continual misconstruction of the actual happenings at trial. It is submitted that a theory directly contrary to his own testimony could not be an "issue tried with the consent of the parties"; that he cannot testify as to his sobriety and now claim intoxication, and that instructions limited in argument and presented to the jury in one light cannot now be stretched to extreme, merely to create error.

Nor can appellant rightly complain of acts of court which inured to his benefit, were brought about by his own testimony or of which he failed to complain at trial.

Dated at Honolulu, Hawaii, this 13th day of May, 1966.

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Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19, of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Burnham H. Greeley

No. 20023

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

McGRAW-EDISON COMPANY, a corporation,
Appellant,

vs.

PREFORMED LINE PRODUCTS COMPANY, a corporation,
Appellee.

APPELLANT'S REPLY BRIEF.

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Appellee.

APPELLANT'S REPLY BRIEF.

Comments on the Brief for Appellee (Preformed).

Preformed's Brief violates Rule 18 of this Court and *Springer v. Best,* C.A. 9, 1959, 264 F. 2d 24, footnote at page 27, by alluding to facts or occurrences not in the record. We list* some of these liberties taken because they set the tone for Preformed's entire brief, Many citations of law and interpretations of facts are just as loosely treated.

*An example is found on page 4, last paragraph, reciting facts occurring in the "Cleveland case" subsequent to dismissal of the present action. The record stops with the preceding paragraph. [R. 200.]

Another example is on page 14, the statement that McGraw-Edison was "working hand-in-glove with Fanner * * *."

A further example appears on page 14, last paragraph, reciting that McGraw-Edison is doing business in Cleveland.

An additional off-the-record and misleading suggestion is made on page 16 that McGraw-Edison orders from Fanner the latter's "old form of dead end" which Fanner has been enjoined from selling. Preformed is aware that the old products held to infringe

Thus, Preformed states that "After dismissal of the complaint, Judge Crocker retained jurisdiction over the parties and controversy pleaded by McGraw-Edison's counterclaim in order to render, as the Rule requires, an independent adjudication of the counterclaim." [Pref. Br. p. 9.] This implies that the counterclaim remained "pending" and that Judge Crocker did independently *adjudicate* the counterclaim. The contrary is obvious from the single order which concurrently disposed of the entire action.

The brief states that the "Lower Court Had the Discretionary Power to Refuse Jurisdiction of the Counterclaim * * *." [Pref. Br. p. 10.], and that "The Lower Court Properly Declined to Accept Jurisdiction Of the Counterclaim in Light of the Cleveland Proceedings." [Pref. Br. p. 11.] These are slanting expressions. The District Court already had "accepted" *jurisdiction* of the counterclaim.

Preformed's charge [Pref. Br. p. 1] that McGraw-Edison's Opening Brief "has curiously omitted from its Statement of the Case any description of the Cleveland litigation" and that "McGraw-Edison's description of the proceedings in this case only sets forth half of the facts in the records" is inaccurate but serves the useful

have been discontinued by Textron, as evidenced by a failure to cite this old form of dead end as a basis for contempt in Preformed's motion for contempt in Cleveland.

On page 19 after referring to the natural and immaterial fact that McGraw-Edison pleaded the Straight-Bight Fanngrip before Preformed's attorney had even seen one, the brief states, without record support "(This is but one of the *many instances* of collaboration between Fanner and McGraw-Edison.)" (Emphasis added.)

The truth or falsity of these unsupported statements is not the criteria. We are not, under the Rule, entitled to deny, qualify, or supplement them, and we refrain from doing so. They should be disregarded in considering the appeal.

purpose of focusing attention to the incompatible positions taken by the respective parties.

It is inaccurate because McGraw-Edison made numerous references to the Cleveland litigation. [M.E. Op. Br. pp. 5, 8, 9, 11, 12, 13, 21, 22, 23, 24, 25, 26, 27, 28, 29, 30, 31, 37, 38, 40, 41, 42, 43, 45, 46 and 47.]

Points in Dispute Are Narrowed.

The Incompatible Positions Are: McGraw-Edison Contends That the California Case Is Controlling as to Its Rights; Preformed Argues That the Cleveland Case Dominates the Entire Controversy and Proscribes McGraw-Edison's Rights in the California Case.

The separation line is clearly emphasized by Preformed in admitting that dismissal would have been contrary to the authorities cited in our opening brief "if, *but only if,* there had been no pending litigation in Cleveland, Ohio." [Pref. Br. pp. 10-11.] Note in addition, that Preformed agrees "that dismissal of the complaint was not in itself a ground for dismissal of the counterclaim * * *" [Pref. Br. p. 12, footnote.]

It is Preformed's contention that the action in Cleveland has, *or will eventually,* dispose of all the issues raised by McGraw-Edison's counterclaim. It clearly will not, and cannot. Moreover, Preformed neglects to add that for such a conclusion, even if all other essential factors are present, the *parties must be the same.*

Summary of Preformed's Argument.

Preformed predicates its case on the proposition that the only major point in issue either in Cleveland or Los Angeles is whether or not the Straight-Bight Fanngrips infringe the Peterson patent. That if such are held to infringe, Fanner will be stopped from manufacturing and

McGraw-Edison's source will be lost,—on the other hand, that if they are not an infringement, such decision enures to McGraw-Edison's benefit [Pref. Br. p. 17], and the controversy thus ends one way or the other.

McGraw-Edison's Response.

Such a premise and such a conclusion are palpably erroneous. The *controversy* is not limited to the Straight-Bight Fanngrips. McGraw-Edison denies that the earlier forms of accused devices infringe, and has challenged the validity of the patent in suit from the inception of its response to the complaint. It has challenged the scope of the patent throughout the same period, and has asserted a misuse of the patent in suit and violation of the Clayton Act. We will now proceed to further consideration of this position.

1. **Even if the Cleveland Court Frees the Straight-Bight Fanngrips From the Patent Monopoly, McGraw-Edison Has the Right to a Trial on the Issues of Validity and Scope.**

Dominion Electrical Mfg. Co. v. Edwin L. Wiegand Co., C. A. 6, 1942, 126 F. 2d 172. As said by Judge Simons at 174-175,

> "* * * One defendant exonerated of infringement may be content with such adjudication—another may not. Electrical Fittings Corp. v. Thomas & Betts Co., 307 U.S. 241, 59 S.Ct. 860, 83 L. Ed. 1263, illustrates the point that mere exoneration from infringement does not always meet the necessities of a wrongfully accused defendant. His activities are still circumscribed by the monopoly based upon the patent grant. Convinced that the patent (or the trademark) is invalid, he is still hampered and embarrassed by the necessity of

avoiding trespass. One structure or representation may escape the charge of infringement. Improvements made to meet competition, may not. He wishes to be freed from the restrictions of an invalid patent or trademark, and he represents not only himself, but, in a sense, also the public which is likewise excluded from the field of monopoly. The Declaratory Judgment Act furnishes him with the means of escape. We see no reason why it should not be available to him as a counterclaim when circumstances would have permitted a separate suit."

To the same point see: *Trico Prods. Corp. v. Anderson Co.,* C. A. 7, 1945, 147 F. 2d 721.

Furthermore, the public interest in the controversy over validity is paramount even to that of the litigants. *Hycon Manufacturing Company v. H. Koch & Sons,* C.A. 9, 1955, 219 F. 2d 353, 355-6.

2. Moreover, Absent Any Infringement Question Involving the Straight-Bight Fanngrips, the Issues Tendered by McGraw-Edison's Counterclaim Which Was Dismissed Are Broader Respecting the Patent in Suit Than Those Decided in the Cleveland Case.

As mentioned by the District Court in Ohio, the Peterson patent contains twenty claims; and only 1, 3, 5, 6, and 8 through 15 were involved in the Cleveland case. These claims were held valid and infringed.

Preformed Line Products Co. v. Fanner Manufacturing Co., U.S. D.C., N.D. Ohio, E.D., 1960, 1962, 225 F. Supp. 762, 775.

Claims 2, 4, 7, and 16 through 20 were not involved, and remain unadjudicated.

Preformed's complaint against MCGraw-Edison here in California charges infringement generally [R. 14-15] in the following language: "* * * the defendants have infringed said Letters Patent by selling and using, or causing to be sold and used, devices embodying the patented invention * * *." No selected claims are specified.

Our counterclaim which was dismissed, tenders issues as to "the validity of Patent No. 2,761,273, the infringement thereof by this defendant, and the rights of this defendant thereunder." [R. 142, *et seq.*] In other words, we attacked the entire patent, which means all of the claims.

The controversy between the parties cannot be subsequently unilaterally narrowed by Preformed, through answers to interrogatories or otherwise, either to specify fewer than all the claims to be infringed, or limiting the charge to certain specified devices, in order to escape a counterclaim, *Sterling Aluminum Products, Inc. v. Bohn Aluminum & Brass Corporation,* C. A. 6, 1962, 298 F. 2d 538, 132 U.S.P.Q. 365, 367; see also *Felburn v. New York Central Railroad Co.,* C.A. 6, 1965, 350 F. 2d 416, 146 U.S.P.Q. 622, 626, cited in our Opening Brief, page 46, to another point; and *Kawneer Co. v. Pittsburgh Plate Glass Co.,* D.C.W. Mich., 1952, 103 F. Supp. 671, 93 U.S.P.Q. 3, containing an extensive review of authorities,—any more than a complete withdrawal of the charge of infringement would relieve Preformed of having to meet McGraw-Edison's counterclaim for declaratory judgment. (See authorities cited in our Opening Brief, p. 39.)

In another case wherein the plaintiff sued on only one claim of several in the patent, the Court "disposed of the patent as a whole [held it invalid] because it has

seemed to us that it should not remain in the art as a scarecrow."

Bresnick v. United States Vitamin Corp., C.A. 2, 1943, 139 F. 2d 239, 242.

If any doubt remains, it should be dissipated by *Altvater v. Freeman*, 319 U.S. 359, 63 S. Ct. 1115, 87 L. Ed. 1450 (1943). This case is final authority for the proposition that the issue of validity may be reached by a counterclaim in an infringement suit, that the controversy between the parties does not come to an end even on the dismissal of the bill for non-infringement since their dispute went beyond the single claim of many in the patents, and beyond the particular accused devices involved in the suit.

3. Our Counterclaim Also Contains Charges Which Must Be Accepted as True* of Patent Misuse and Violation of Section 3 of the Clayton Act (15 U.S.C. 14).

These charges of misuse and antitrust violations are found in the Record at pages 142-144, incorporating by reference the Second, Third and Fourth Defenses, set forth at pages 138-140.

This tenders *issues of public interest* which cannot be avoided by Preformed even under the doctrine of *res judicata*, *Mercoid Corp. v. Mid Continent Investment Co.*, 320 U.S. 661, at 670-671, 64 S. Ct. 268, 88 L. Ed. 376, at 383-384, 60 U.S.P.Q. 21.

*In addition to the case cited on page 30 of our Opening Brief to the point that the allegations of our counterclaim must be taken as true, see *Walker Process Equipment Inc. v. Food Machinery & Chemical Corp.*, U.S. Sup. Ct., Dec. 6, 1965, ... U.S., 147 U.S.P.Q. 404, 406 I., reversing a decision by the Court of Appeals for the Second Circuit dismissing a counterclaim by an alleged infringer for antitrust violation.

4. Reimbursement by Textron of McGraw-Edison's Expenses Is No Ground to Deny Relief to the Latter.

Preformed lays great stress on the fact that "Fanner is financing this litigation," and that any indemnity obligation favoring McGraw-Edison Company ceased "when Preformed offered to dismiss its complaint." [Pref. Br. pp. 12-13.]

In the first place, this assistance was based on a statutory obligation of Fanner,** originating long before Fanner was ever enjoined (Textron Inc. has never been enjoined), as distinguished from a voluntary contribution by a party to a defense fund initiated after the party was under injunction, noted in *Bates Refrigerating Co. v. Gillette,* 30 Fed. 683. [Pref. Br. p. 14.] If McGraw-Edison eventually were forced to defend itself in the Cleveland case against the charge that it has aided and abetted Textron in the alleged violation of the injunction, and Textron reimbursed McGraw-Edison for its legal expenses therein under the indemnity obliga-

**The pertinent indemnity provision of the Ohio Revised Code, under which Fanner (former manufacturer) and Textron (present manufacturer) were obligated to McGraw-Edison Company, is §1302.25 (UCC 2-312) which reads as follows:

> "Warranty of title and against infringement; buyer's obligation against infringement.
>
> * * *
>
> (C) Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications."

The Uniform Commercial Code of California, §2312(3) contains wording identical to subdivision (C) quoted above.

Thus Fanner was and Textron is legally obligated by way of indemnity whether the sale is construed as made in Ohio or California.

tion, that circumstance according to Preformed's theory, would *ipso facto* constitute additional "collusion" between Textron and McGraw-Edison and furnish the grounds to have McGraw-Edison held in contempt because it defended itself in the contempt proceedings at the expense of Textron.

In the second place, the offer to dismiss was *without* prejudice, and the threat of litigation still hangs over McGraw-Edison's head by the terms of the offer, as well as by Preformed's motion for contempt against McGraw-Edison in Ohio.

The statment of Preformed that McGraw-Edison's need to "defend" has long since passed [Pref. Br. p. 17, footnote] is without substance. Preformed itself leaves the door open by the statement that "After Preformed is compensated for the tortious acts of Fanner in the Cleveland case, Preformed could not and would not expect to recover on account of infringement by the identical articles through their sale by McGraw-Edison in California or elsewhere [R. 336, 346, 356]." [Pref. Br. p. 24.] What happens to McGraw-Edison if Preformed is not fully compensated by Fanner, the original defendant, which is no longer in existence? What happens to McGraw-Edison if Textron which is said to be a successor of Fanner, and was never a party to the suit, does not satisfy a judgment? Let Preformed's offer to dismiss its California complaint be construed as a grant of immunity for all time or purposes to McGraw-Edison to use any kind of material made by anyone that comes within the claims of the patent in suit such that McGraw-Edison has a free nonrevocable license under the patent in suit, and the need to defend does vanish. We invite Preformed to confirm such a construction.

5. Abuse, Arbitrary, or Improvident Exercise of Discretion Is Fully Supported by the Record.

Preformed contends that "the conclusion is inescapable that it was within Judge Crocker's sound discretion to refuse to assume jurisdiction" of our counterclaim. [Pref. Br. p. 10]. The brief further states that such conclusion is required by the Declaratory Judgment Act, and such cases as *Public Affairs Associates, Inc. v. Rickover,* 369 U.S. 111, 82 S. Ct. 580, 7 L. Ed. 2d 604 (1962). However, in that case the Supreme Court stated, among other things, "Of course a District Court cannot decline to entertain such an action as a matter of whim or personal disinclination * * *."

Further, on the broad doctrine that a court has discretion over accepting a declaratory judgment action, Preformed cites *American Greiner Electronic, Inc. v. Establissements Henry-Le Paute,* S.A., 174 F. Supp. 918 (D.D.C. 1959). [Pref. Br. p. 11.]

In that case a declaratory judgment action, which was filed first by American Greiner was declined jurisdiction by the trial court where the *same party,* American Greiner, had been sued by the patentee in another district subsequent to the filing of the declaratory judgment action. What Preformed completely ignores in relying on this case is that in both suits *the parties were the same.* In the instant situation this is not true at all but rather, in Ohio, Preformed first sued a *manufacturer* and then, in California, for its own unexplained reasons which it now chooses to ignore, *Preformed* initiated a suit against a *customer* who responded with a counterclaim seeking declaratory relief.

Preformed also argues that there is "no showing that the lower Court clearly abused its discretion in dismissing McGraw-Edison's counterclaim without prejudice."

[Pref. Br. p. 24.] What kind of a "showing" should be made is not delineated.

We do not believe that any right to exercise discretion remained with the District Court at the time and under the circumstances and in the light of Rule 41(a)(2) at the date of dismissal. However, the whole history of the case demonstrates that *if* the Court were permitted the exercise of discretion it abused the same or exercised it arbitrarily or improvidently.

Preformed's counsel approved the "form and substance," *i.e. stipulated,* to the Order Removing Action From Trial Calendar, having joined in the motion which resulted in the order, dated November 3, 1959. [R. 25.]

At that time both litigants and the District Court knew that the Cleveland case had been tried and was under submission. The stipulated order recites "that the decision in said case *might* dispose of this action." (Emphasis added.)

That, followed by the provision that the California case "may be restored to the trial calendar by *either party* upon ten days' notice to the other or by order of the Court" constitutes a clear recognition by the parties and the Court that the action might be disposed of under one set of circumstances, but could and should proceed under another. (Emphasis ours.)

More specifically, the proper and logical interpretation must be that if the patent were held invalid the California action might be disposed of, but if any of the claims of the patent were held valid, McGraw-Edison would have its day in court.

There was no question then that the District Court in California had jurisdiction of the parties and of the action, including the counterclaims then on file.

Preformed cannot point to any fact arising since that date which could nullify that stipulated Court order.

To the contrary, the District Court in California was informed by Preformed's counsel in a hearing held October 15, 1962 that in the Cleveland case "The patent was held valid and infringed * * * both sides have appealed to the Sixth Circuit." After colloquy between Court and counsel for both parties the Court said: "Very well. Then let's take it [the California case] off calendar, to be set for trial as soon as you gentlemen are ready. Will that do?" It was then pointed out to the Court that there already was an outstanding order that it would be taken off calendar, to be restored at anyone's move on ten days' notice, or by the Court, at any time. After further discussion, the Court said: "Very well. We will continue with the same order [the order of November 3, 1959] * * *." [R. 28 (b,-c).]

The subsequent bringing of the motion to dismiss, and the order granting it, to which this appeal is directed, were wholly inconsistent with the letter and spirit of the original stipulated order, as reaffirmed on October 15, 1962.

Moreover, on June 15, 1964, after the case had been restored to the trial calendar, at a hearing involving, among other things, McGraw-Edison's motion to amend and file a supplemental answer and counterclaim, Preformed's counsel stated to the Court, "I have no objection to filing the supplemental answer and counterclaim" except for the sixth defense and the fifth cause of the counterclaim. [R. 46 (b).]

At that hearing, counsel for Preformed advised the District Court that the decision in the Cleveland case had been sustained by the Court of Appeals and peti-

tion for rehearing was filed and denied. He further stated: "Now, McGraw-Edison is a seller of a particular structure manufactured by the defendant in the Ohio case and there is an agreement between McGraw and the defendant in the Ohio case that McGraw-Edison will be held harmless for anything they sell of the things held to be infringed in the Ohio case because of the fact they let it go to trial and decided in Ohio."

The Court responded, "We can try it here." Counsel for Preformed responded, "Sure * * *." [R. 46-(j).]

That is correct, and is consonant with the well established rule of law that "The purchaser of a manufactured product should not be barred, of course, from defending a suit brought against him by a patentee for infringement by a finding of infringement against the manufacturer, for the very good reason that he has had no opportunity to be heard with respect to infringement in the suit against the manufacturer."

> *General Chemical Co. v. Standard Wholesale Phosphate & Acid Works, Inc.,* C.A. 4, 1939, 101 F. 2d 178, 181.

Furthermore, a patent infringement suit is clearly *in personam*. It concludes the parties. It concludes nobody else. A second suit against other parties starts afresh, and the second court is free to disregard the earlier ruling, if so advised.

> *Traitel Marble Company v. U. T. Hungerford Brass & Copper Co.,* C.A. 2, 18 F. 2d 66.

Preformed's counsel concedes that to be valid law. He stated during an argument before the District Court September 24, 1964 [R. 47]:

> "These suits [in Cleveland and California] are in personam, and of course where you have the same

> plaintiff and different defendants there is an entitlement of that second defendant to be heard notwithstanding a judgment against a defendant in the first instance."

He argued, however, that the law does not apply to our case, and among the reasons advanced was "that the evidence that we *hope* to bring before the court *ultimately* in this case in support of the motion that we *plan to bring* to supplement our Complaint will support the showing that the present suit is being maintained and controlled by Fanner." (Emphasis ours.)

He further conceded that McGraw-Edison is entitled under Judge Learned Hand's *in personam* doctrine (*Traitel Marble* case) to "relitigate" if Fanner is not in control of the California case. [R. 348.]

The "hope" mentioned has never reached fruition. No evidence of such character has been presented to the District Court, no motion to "supplement" the Complaint has been served or filed. The "hope" was announced in the fall of 1964, about six and a half years after the complaint was filed. Four months later, when the motion to dismiss was filed, the "hope" was still a dream.

Having failed in that approach, Preformed evidently concluded, and in its Brief before this Court admits in effect that *res judicata* cannot support the dismissal of our counterclaim. [Pref. Br. p. 16.] Preformed actually had no choice. The cases cited by us, as to the requirements for *res judicata* [M.E. Op. Br. pp. 32-36], are all either Ninth Circuit cases or in accord with the Ninth Circuit. One of them, *Aghnides et al. v. Holden et al.*, C.A. 7, 1955, 226 F. 2d 949, 107 U.S.P.Q. 195, was cited with approval in *Technograph Printed Circuits*,

Ltd. v. Methode Electronics, Inc., C.A. 7, 1966, ... F. 2d, 148 U.S.P.Q. 181, 185.

Abandoning the "hope" of supporting *res judicata* in the California case, Preformed then changed tactics and on November 13, 1964 filed in the Cleveland case a supplemental motion to punish for contempt [R. 185] in which it alleged *upon information and belief* that McGraw-Edison Company "conspired, colluded, assisted and/or participated with Textron, Inc." in acts of contempt; and prayed that McGraw-Edison Company be enjoined from further prosecution of the litigation in California. [R. 186.]

On page 16 of Preformed's Brief, Preformed remarks that it is up to the Cleveland court to decide whether McGraw-Edison knowingly aided and abetted Fanner in any violation of the Cleveland injunction, asserting that no reason exists as to why "McGraw-Edison will not be given full opportunity to be heard on these issues." Does Preformed, by these quoted statements, also represent that McGraw- Edison will be given a full opportunity to be heard on the question of validity of the Peterson patent, including the claims not adjudicated in the Cleveland case, misuse, and antitrust, which it has raised in its counterclaim? And a chance to try the question of infringement posed by all dead end products, including the old as well as the new and different product over which no judicial determination has been made in *either* the Cleveland or California suits? And to fully try such questions in the injunction proceedings? Obviously, the answer is no in each instance. Nor does Preformed want McGraw-Edison to have the opportunity to litigate such issues.

If the contempt motion is proceeding toward trial in Ohio as to Textron Inc., in consolidation with a de-

claratory judgment action brought by Textron Inc., as represented by Preformed [Pref. Br. p. 19.], *it is not proceeding there as to McGraw-Edison.* [Restraining Order, R. 227, and Consent, R. 316.]

Note also, the assurance of Preformed's counsel at a hearing before the District Court in California on March 22, 1965 [R. 313 (a), at p. 313 (cc)]:

> "We are not going to proceed against McGraw-Edison at all in the Cleveland case; we aren't going to take any action whatsoever * * *."

If such assurance was intended only to last as long as Judge Crocker's reinstatement of restraining order remains in effect, the order does not expire until the final decision by this Court of Appeals on the present appeal. [R. 228.] Meanwhile, McGraw-Edison is "unconvicted" of anything which could prejudice its position before this Court.

6. It Is Not Even Necessary That an Abuse of Discretion Be Found in Order to Reverse the Judgment of the District Court.

This Court so decided in *Delno v. Market St. Ry. Co.,* 124 F. 2d 965 (1942) cited in our Opening Brief at page 21. In the court's opinion Circuit Judge Haney said, at page 968:

> "We think * * * that we may substitute our judgment for that of the court below. Professor Borchard agrees with that view. Borchard, Declaratory Judgments, 2d Ed., pp. 253, 254, 293, 294."

This is not overruled by *Wheeldin v. Wheeler,* C.A. 9, 1960, 280 F.2d 293, cited by Preformed [Pref. Br. p. 25] where this Court in a per curiam decision involving a declaratory judgment action as to validity of subpoenas, etc., affirmed a dismissal by the District Court

"for the reason that entertainment of the claim * * * was discretionary with the district court."

Obviously this Court of Appeals had no criticism of the District Court's ruling and therefore had no occasion to further comment.

The principle that the Court of Appeals may substitute its judgment for that of the District Court, even in a matter involving discretion, is parallel to another long established doctrine. This doctrine holds that in cases where the facts are not disputed, or where the record is documentary, and the credibility of witnesses is not involved, or where the report of a Special Master is for all practical purposes the judgment appealed from, the Court of Appeals may disregard the "clearly erroneous" rule, and give independent consideration to the questions involved. *Oriental Foods v. Chun King Sales,* C.A. 9, 1957, 244 F. 2d 909, 913; *Wilson-Western Sporting Goods v. Barnhart,* C.A. 9, 1936, 81 F. 2d 108, 109; *Falkenberg v. Golding.* C.A. 7, 1952, 195 F. 2d 482, 486.

In the present case before this Court there was no trial, no testimony of witnesses, the record is entirely documentary, there are no findings of fact or conclusions of law, there is no conflict in the record as to the facts, and this Court of Appeals is free to independently decide the questions involved without predicating its ruling on a finding that the District Court abused its discretion, or even that its dismissal of our counterclaim was clearly erroneous.

7. McGraw-Edison's Point That It Is Being Deprived of Due Process of Law Is Well Founded.

Preformed argues that its "charge" that both Fanner and McGraw-Edison are acting in contempt of the Cleveland Court when "they collaborate" to maintain the

California action "was in itself sufficient grounds for Judge Crocker to dismiss the counterclaim." [Pref. Br. p. 15.]

Since when does an *unproved* charge, made on *information* and *belief,* against a corporation *not a party* in the case wherein the charge is made, constitute grounds for *dismissal* of another pending action over which the Court has had jurisdiction of the cause and the parties for approximately seven years, and which had been *set for trial?* [R. 363.]

Preformed's comment that our due process argument evidences a basic misconception of the contempt motion [Pref. Br. p. 15] is predicated on the fallacious proposition that while *res judicata* is not available to Preformed in the California case which was proceeding to trial, it is applicable to the contempt motion in Cleveland. We suggest that McGraw-Edison's failure to subscribe to such an untenable conclusion is understandable.

Preformed "does not contend that McGraw-Edison is bound by the Cleveland injunction" [Pref. Br. p. 15] but does contend that McGraw-Edison was bound to observe its restrictions to the extent that it must not aid or abet its violation by others, through "collusion," or working "hand-in-glove," with Textron.*

*The Cleveland injunction is directed to the Fanner Manufacturing Company (now extinct), its officers, agents, servants, employees, attorneys, successors and assigns, and all those controlling defendant, in privity, active concert or participation with defendant, or controlled by defendant, or any thereof, and permanently enjoins them from directly or indirectly making or causing to be made, using or causing to be used, selling or causing to be sold, articles embodying, or made by using, the invention or inventions embraced or covered by certain specified claims of the patent, and from infringing upon the same claims of the patent in any wise whatsoever, and in any way, directly or indirectly contributing to the infringement of the patent by others. [Record, Pages 189-190]

Whether Textron, as the successor of Fanner, has committed any act of violation of such injunction is not before this court.

The only question involving the Cleveland injunction before this Court, as posed by Preformed, is whether McGraw-Edison is barred from litigating its own rights in an action brought by Preformed against McGraw-Edison in California, where a full trial on all issues could be had.

The *terms* of the Cleveland injunction do not preclude McGraw-Edison from litigating. Even if the terms of the injunction had been broad enough to cover litigating (as distinguished from acts of infringement), the record is completely devoid of any factual support which would establish privity between McGraw-Edison and Textron.

In upholding McGraw-Edison's right to litigate, this Court would not be invading the right of the Cleveland Court to construe its own injunction, because such injunction is directed only against infringement, and neither by its terms nor implications could it be construed to bar litigation by a defendant in California who is a stranger to the Cleveland case.

We re-emphasize that to sustain the dismissal of McGraw-Edison's counterclaim in the California case in "light of the * * * pending litigation in Cleveland, Ohio" [R. 226], would deprive McGraw-Edison of due process of law.

The District Court in California partially properly construed McGraw-Edison's rights when it granted the Temporary Restraining Order on January 15, 1965 [R. 173.] Its error arose in granting Preformed's motion to dismiss which was filed four days later, January 19, 1965. [R. 197.]

Preformed comments [Pref. Br. p. 21] on the fact that we did not see fit to discuss in our Opening Brief the case of *E. B. Kaiser Co. v. Ric-Wil Co.*, N.D. Ohio, 1950, 95 F. Supp. 54. The reason we passed it

by is because it is in no way analogous to the present situation.

Now, however, we cannot let go unchallenged Preformed's assertion that as regards Fanner-made products, that case "presents the same factual situation as the case at bar." [Pref. Br. p. 21.]

In *Kaiser,* a patent owner and a manufacturer were the parties involved, *and the only parties* to the litigation.

The patent owner in *Kaiser* first sued the manufacturer in Illinois where the product was held to be an infringement. Subsequently the *same manufacturer* brought an action in Ohio against the *same patentee* which was dismissed by the Ohio court. In the instant situation, Preformed brought an action against the manufacturer in Cleveland and, while that suit was pending, brought suit against the customer in California. Preformed, having won against the manufacturer in Cleveland, now retreats from its multiple filing of suits and blandly states the customer in California should have no right to contest the issues initially raised by Preformed. Obviously the *Kaiser* decision is inapposite. In that case both parties had their day in court. In our case, McGraw-Edison has not.

The judgment of the District Court should be reversed and McGraw-Edison's counterclaim be reinstated.

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Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

HERBERT A. HUEBNER

No. 20006

In the

United States Court of Appeals

For the Ninth Circuit

LUIGI BAFICO,
Appellant,

v.

SOUTHERN PACIFIC COMPANY,
Appellee,

v.

DAD'S ROOT BEER BOTTLING COMPANY OF PORTLAND, OREGON,
Third-Party Defendant.

PETITION FOR REHEARING

On Appeal from the United States District Court
For the District of Oregon
HONORABLE WILLIAM G. EAST, *Judge*

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PETITION FOR REHEARING

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HONORABLE WILLIAM G. EAST, *Judge*

Plaintiff respectfully petitions this Honorable Court for a rehearing of this cause on the ground that the opinion of the Court heretofore given is erroneous in the following respects:

I.

The Court's opinion overrules Hicklin v. Anders, 201 Or 128, 253 P2d 897, 269 P2d 521 (1954) where it was held that releases must be given effect according to the intention of the parties.

II.

The Court's opinion overrules Keadle v. Padden, 143 Or 350, 20 P2d 403, 22 P2d 892 (1933) where it was held that a litigant who was not a party to the written agreement upon which he seeks to rely, may not prevent the introduction of parol evidence to establish the intention of the parties to the agreement.

III.

The sum of $16,500 gross is not a large sum for compromise by Dad's Root Beer Company of Portland of a permanent injury and whether it is settlement in full for Mr. Bafico should be a question of fact for Mr. Bafico's jury.

IV.

The Court by this decision instead of continuing to take the lead in advancing the law in the area of releases will be retreating toward the common law rule that the release of one joint tort-feasor releases all, regardless of intention or written reservation.

V.

To place this Court's decision on the basis that both the tort-feasors are released upon the release of one where, as in the case at bar, the negligence of the tort-feasors materialized in a single accident rather than, as in Rudick v. Pioneer Memorial Hospital, 9 Cir., 1961,

296 F2d 316, where there were two occurrences of negligence separate in time and space, adds further complication to an area of law which already is complex, and raises the question of whether, when there are two occurrences of negligence separate in time and space, there can be joint-feasors.

VI.

At the time Mr. Bafico signed the Dad's Root Beer release, the Southern Pacific Company was not a corporation *charged* with responsibility for injuries to Mr. Bafico and as a result the language of the Rudick release would be stronger language for this defendant's position.

VII.

The trial court and this Court had no basis in the record for the inference that Mr. Bafico knew what he was doing (releasing the Southern Pacific Company) when he signed the release for Dad's Root Beer, simply because the release was signed in the presence of his counsel.

VIII.

Mr. Bafico, the real party in interest, did find this release to be ambiguous.

IX.

The law in Oregon on uncommunicated mental reservations, as set out in Wheeler v. White Rock Bottling Co., 229 Or 360, 366 P2d 527 (1961), applies only as between the parties to the release and is not authority for the finding that any uncommunicated mental reservations between the parties to the release inures to the benefit of a third party not in privy or that any reservation, mental or otherwise, about another tort-feasor must be communicated to the released tort-feasor in order not to be waived.

X.

This Court, through Judge Hamlin, Judge Merrill, and Judge Koelsch, has previously considered and rejected in the Rudick case the arguments advanced and the authorities cited by appellee, including Wheeler v. White Rock Bottling Company.

Respectfully submitted,

MARTIN SCHEDLER,
Attorney for Appellant

I hereby certify that in my judgment the within petition for rehearing is well founded and is not interposed for delay.

Attorney for Appellant
MARTIN SCHEDLER

No. 20030

United States Court of Appeals

FOR THE NINTH CIRCUIT

CALIFORNIA CITIZENS BAND ASSOCIATION, INCORPORATED, a Corporation,
Petitioner,

vs.

THE UNITED STATES OF AMERICA and FEDERAL COMMUNICATIONS COMMISSION,
Respondents.

PETITIONER'S OPENING BRIEF

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No. 20030

United States Court of Appeals

FOR THE NINTH CIRCUIT

CALIFORNIA CITIZENS BAND ASSOCIATION, INCORPORATED, a Corporation,
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vs.

THE UNITED STATES OF AMERICA and FEDERAL COMMUNICATIONS COMMISSION,
Respondents.

PETITIONER'S OPENING BRIEF

I. INTRODUCTORY

Petitioner, CALIFORNIA CITIZENS BAND ASSOCIATION, INCORPORATED, is a tax exempt, non-profit corporation, duly incorporated under the laws of the State of California, a citizen and resident of the State of California with its principal office in Alameda County, California. Each member of petitioner is an organized Citizens Band Radio Club, membership of which consists of radio station licensees, duly licensed by respondent FEDERAL COMMUNICATIONS COMMISSION to hold radio station licenses in the Class D Citizens Band. That there are approximately nine clubs located in

Northern California which are members of petitioner. That the members of the individual clubs are from all walks of life, including invalids and disabled persons. That petitioner herein timely filed its petition for rehearing in regard to the proposed rule changes on August 26, 1964. (Transcript of record Vol. 2-C, pg. 846-852).

The Citizens Radio Service is a relatively recent avenue of communication afforded citizens of the United States. No technical radio knowledge is necessary to obtain a license, and the only thing the applicant must do to qualify is to familliarize himself with the rules and regulations of the respondent Commission pertaining to the Citizens Radio Service. The Citizens Radio Service differs from the Amateur Service in that the amateur, in order to obtain his license, must pass a code reception and radio theory examination. The Citizens Radio Service is a low-powered, short range system of communication. There are four classifications of station licenses in the Citizens Radio Service which are listed as follows:

1. Class A which is on an assigned frequency available to that service in the 460-470 MC/S frequency band, with an authorized plate input power of 60 watts, or less;

2. Class B which is one on an authorized frequency available to that service in the 460-470 MC/S frequency band with an authorized plate input power of 5 watts, or less;

3. Class C is a station operating on an authorized frequency in the 26.96-27.23 MC/S frequency band, or on the frequency 27.255 MC/S, for the control of remote objects or devices by radio, or for the remote actuation of devices which are used solely as a means of attracting attention;

4. Class D is a station operating on an authorized frequency in the 26.96-27.23 MC/S frequency band, or on the frequency 27.255 MC/S with an authorized plate input power of 5 watts, or less, for radiotelephony only. (There are 23 channels of communication in this band.)

A Class A station is authorized to operate as a mobile station, as a base station, or as a fixed station. The remaining stations are primarily licensed as mobile stations, but under certain conditions may operate at fixed locations. In our text herein, we are concerned only with the Class D Station and not the other three. At the present time, there are approximately 1,000,000 Class D Stations licensed by respondent FEDERAL COMMUNICATIONS COMMISSION to operate one or more units.

Citizens Radio Service equipment is readily available and its use is widespread and valuable. In times of emergency, the Service has saved lives and property and, in many instances, has been the sole means of communication in stricken areas. The use of Citizens Radio Service, or "CB" as it is known, has been of inestimable help to farmers and others in rural

and remote areas in enabling them to communicate with their bases of operation. Civilian Defense groups have made great use of CB, as have many law enforcement agencies. Thousands of businesses have and still are employing CB in their commercial activities such as communication between company vehicles and headquarters. Millions of dollars have been spent by licensees for CB radio equipment. An examination of the transcript herein will show that CB'ers hailing from every section of our country are concerned with the rule changes of respondent FEDERAL COMMUNICATIONS COMMISSION which became effective April 26, 1965.

II. HISTORY OF THE CITIZEN'S RADIO SERVICE

In 1944, in Docket No. 6651, see *9FR10270-10272* respondent Commission recognized the fact that a complete review of present allocations of bands of frequencies in the radio spectrum was necessary as the result of important advances in the radio art which were made during the war and the demands for the use of radio which were greatly increased. Pursuant thereto, the respondent commission announced that a hearing would be held on September 28, 1944 to consider the foregoing and related matters.

In *10 FR 2257-2258*, under date of February 27, 1945, respondent Commission announced oral argument in regard to Docket No. 6651 would be heard February 28, 1945, and that one of the items to be considered was the Citizens Radio Communication

Service. This was the first time that the aforesaid designation was used.

In *11 FR 11227-11230*, under date of September 17, 1946, respondent Commission adopted a new table of service-allocations of frequencies. Included therein was an allocation of 460-470 MC/S to the "non-government citizens radio." Again on November 13, 1946, see *11 FR 13704-13707*, the respondent stated that it would be interested in "securing the cooperation of maufacturers and others in preparing technical requirements for equipment to be used in the Citizens Radio Communication Service." The respondent Commission further stated on page 13705 as follows:

> "The posible uses of this service are as broad as the imagination of the public and the ingenuity of equipment manufacturers can devise. . . ."

The respondent Commision then went on to allocate the band to Class A and Class B Stations. Said respondent then went on to explain how type approval for the equipment to be used could be obtained. The Citizens Band was thus on its way to becoming a reality.

On July 15, 1947, in *12 FR 4689*, respondent Commission outlined the proposed frequencies to be used by Class A and B Stations, frequency tolerance and the procedure for securing type approval of equipment.

On October 31, 1947, in *12 FR 7081*, respondent Commission announced that effective December 1, 1947, a new Part 19, entitled "Rules and Regulations Governing Citizens Radio Service" be created. In *19.1* Basis and Purpose, respondent stated:

> "The following rules and regulations are issued pursuant to the provisions of Title III of the Communications Act of 1934, as amended which vests authority in the Federal Communications Commission to regulate radio transmissions and to issue licenses for radio stations. These rules are designated to provide short-distance radio communication, radio signalling, and control of objects by radio with minimum licensing requirements, and to provide procedures whereby maufacturers of radio equipment to be used or operated in the Citizens Radio Service may obtain type approval of such equipment."

The first rules governing CB were thus created. An analysis of the same will show that they were relatively simple. However, on the same day of October 31, 1947, respondent in *12 FR 7095* stated that it expected to publish proposed rule making covering licensing procedure and regulations concerning the use or operation of stations in the near future. Also, that licenses would not be isued until the complete Part 19 was adopted.

On June 23, 1948 in *13 FR 3377*, the official definition of respondent for the Citizens Radio Service was given as follows:

> "A radio communication service of fixed, land or mobile stations, or combinations thereof, intended for use by citizens of the United States for private or personal radio communication (including radio signalling, control of objects by radio, and other purposes.)"

On August 19, 1948, in *13 FR 4796-4798*, respondent gave notice of proposed rule making in regard to the completion of Part 19. Under *19.2* the definition of Citizens Radio Service was given as follows:

> "A fixed and mobile service intended for use for private or personal radio communication, radio signalling, control of objects or devices by radio, and other purposes not specifically prohibited herein. Any citizen of the United States eighteen years of age or over is eligible to be licensed in this service."

Section *19.59* states in regard to permissible communications:

> (a) "Each station in the Citizens Radio Service is authorized to communicate with other stations in this service."

On April 5, 1949, in *14 FR 1597*, respondent Commission announced that the applications on file of persons who were eligible under the rules governing any other service would be put in the pending file and would not be acted upon until final agency determination.

In 1951, in *16 FR 11738*, the respondent announced proposed rule making to permit a new class (c) of radio station which may be used for the control of objects or devices by radio on the frequency 27.255 MC.

In 1955, applications for licenses were still not being granted but were placed in the pending files. See *20 FR 857*.

On December 19, 1956, in *21 FR 10414*, respondent Commission proposed to delete the requirement that applications from those who are eligible under the rules governing any other service be placed in the pending file. Comments were invited.

On April 16, 1957, respondent Commission published in *22 FR 2583*, its proposal that 26.96-27.3 MC/S band be reallocated to the Citizens Radio Service. In addition, respondent Commission amended *Part 19.2* to read as follows:

> "*Citizens Radio Service*s A fixed and mobile radio service intended for personal or business radio communication, radio signalling, control of remote objects or devices by means of radio, and other purposes not specifically prohibited in this part."

Part 19.51 (b) reads:

> "Any station licensed in this service may be used to provide a radio communication service

> to any person, including the licensee of another station in the same service, on a strictly voluntary and no-charge basis; however, no other form of cooperative or shared use of facilities licensed in this service shall be permitted."

On April 17, 1957, in *22 FR 2684*, respondent proposed to institute further inquiry into the allocation of frequencies to non-governmental services in the radio spectrum between 25 MC's and 890 MC's.

Then again on June 28, 1957, *22 FR 4533*, the Commission defines the Citizens Radio Service as follows:

> "A radio communication service of fixed land or mobile stations, or combinations thereof, intended for use by citizens of the United States for private or personal radio communication (including radio signalling) control of objects by radio, and other purposes."

On April 24, 1958, in *23 FR 2737-2740* respondent announced the amendment of Part 19 to be effective May 28, 1958. Section *19.2 (a)* as amended, reads as follows:

> "Definitions (a) Citizens Radio Service. A service of fixed, land and mobile stations intended for personal or business radio communication, radio signalling, control of remote objects or devices by means of radio, and other purposes not specifically prohibited in this part."

On August 9, 1958, in *23 FR 6111-6112*, respondent announced that effective September 11, 1958, the 26.96-27.23 MC/S band would be allocated to the Citizens Radio Service. Further, on the aforesaid date, in *23 FR 6132*, effective September 11, 1958, respondent amended *Part 19.2* to include the Class D Citizens Radio Station, which was defined as follows:

> "A mobile station in the Citizens Radio Service operating on an authorized frequency in the 26.96-27.23 MC frequency band with an authorized plate input power of 5 watts, or less, for radiotelephony only. (Class D stations are authorized to operate as mobile stations only; however, they may be operated at fixed locations in acordance with other provisions of this part)"

Part 19 was further amended effective September 11, 1958, to provide the rules and regulations for the operation of the aforesaid Class D stations. Licenses for all stations in the Citizens Radio Service were to be issued for a term of five years.

On March 12, 1959, in *24 FR 1791*, respondent allocated 27.255 MC to be used by Class D stations on a shared basis with stations in other services, effective April 15, 1959. Class D stations thus were able to operate on 23 channels in the band and the frequencies were set forth in *19.31 (d)* to read as follows:

"MC	MC	MC	MC
26.965	27.035	27.115	27.185
26.975	27.055	27,125	27.205
26.985	27.065	27.135	27.215
27.005	27.075	27.155	27.225
27.015	27.085	27.165	27.255
27.025	27.105	27.175"	

On July 29, 1959, in *24 FR 6059-6060*, respondent proposed for the first time that there be a silent period after five minutes of communication between Class D stations. Also, that all transmissions from a Class D station must be addresed to specific persons or stations. Comments were invited.

On February 17, 1960, in *25 FR 1408*, respondent Commission referred to its proposals of July 29, 1960 *(24 FR 6059)* by issuing a policy statement outlining new rules. The respondent stated as follows on pages 1408-1409 (in regard to comments which had been sent in):

> "Due to the large number, it is not feasible to list here all such comments nor to discuss the various positions of all interested parties. No effort was made to tabulate the number of parties whether supporting or opposing the proposed changes. In this connection, it should be noted that one comment which contains logical and sound reason is more helpful to the Commission and is entitled to more weight by the Commission in the disposition of the issues involved in the proceeding."

Further, the Commission points out that its intention is that the Citizens Radio Service is contemplated basically as a service for intercommunication between units of a single station rather than between separate stations. This, apparently, is the first time that the Commission has stated such a policy.

In addition, amended *paragraph f of Section 19.61* limited any exchange of communications between two or more Class D stations to not more than 5 consecutive minutes followed by a two minute silent period during which the licensee shall monitor the frequencies used and other stations provided an opportunity to the use the frequencies.

The aforesaid amendments were made effective March 15, 1960.

On November 22, 1962, in *27 FR 11500*, respondent Commision initiated the proposed rule making which eventually culminated in the adoption of the rules which went into effect April 26, 1965, and which petitioner attacks herein. The proceeding was entitled "Docket 14843." Comments were invited and thousands of persons responded. No public hearings were held although the same were requested. (See Transcript of Record, Vol. II-D, page 932 and Vol. II-C, page 852). A copy of the proposed rule making is attached to petitioner's petition and marked "Exhibit A". It will be noted that respondent Commision had evidence independent of the comments of interested persons in that *27 FR 11500* states as follows:

> "However, monitoring, inspections and investigations by the Commision as well as numerous letters from licensees complaining of the unnecesary interference to their operations indicate that misuse of citizens radio station operaing privileges is so prevalent in some areas as to threaten the continued usefulness of the service."

Several stay orders were granted and, subsequently, *Part 19*, which was re-designated as *Part 95*, went into effect as amended on April 26, 1965.

III. JURISDICTION

47 USC Section 303 provides that the Federal Communications Commission has the power in the public interest to make rules and regulations controlling radio station operation in the United States not inconsistent with law and to enforce the same. *47 USC Sec. 303 (r)* states:

> "Make such rules and regulations and prescribe such restrictions and conditions, not inconsistent with law, as may be necesary to carry out the provisions of this chapter, or any international radio or wire communications treaty or convention, or regulations annexed thereto, including any treaty or convention insofar as it relates to the use of radio, to which the United States is or may hereafter become a party."

Thus respondent Commision had the authority to promulgate rules to govern the Citizens Radio Service.

On February 24, 1965, respondent Commission adopted the proposed rules which went into effect April 26, 1965, and denied petitioner's petition for re-hearing and reconsideration which was duly filed on August 26, 1964.

47 USC Sec. 402 (a) provides:

> "Any proceeding to enjoin, set aside, annul or suspend any order of the Commission under this chapter (except those appealable under subsection (b) of this section) shall be brought as provided by and in the manner prescribed in chapter 19A of Title 5."

Further *5 USC 1033* states:

> "The venue of any proceeding under this chapter shall be in the judicial circuit wherein is the residence of the party or any of the parties filing the petition for review, or wherein such party or any of such parties has its principal office, or in the United States Court of Appeals for the District of Columbia."

Plaintiffs residence for purposes of venue being in California, the petition is properly filed in the United States Court of Appeals, Ninth Circuit.

5 USC 1034 provides as follows:

> "Any party aggrieved by a final order reviewable under this chapter may, within sixty days after entry of such order, file in the court of

appeals, wherein the venue as prescribed by section 1033 of this title lies, a petition to review such order. Upon the entry of such an order, notice thereof shall be given promptly by the agency by service or publication in accordance

with the rules of such agency. The action in court shall be brought against the United States. The petition shall contain a concise statement of (a) the nature of the proceedings as to which review is sought, (b) the facts upon which venue is based, (c) the grounds on which relief is sought, and (d) the relief prayed. The petitioner shall attach to the petition, as exhibits, copies of the order, report, or decision of the agency. The clerk shall serve a true copy of the petition upon the agency and upon the Attorney General of the United States by mailing by registered mail, with request for return receipt, a true copy to the agency and a true copy to the Attorney General."

Based upon the above quoted *47 USC 402 (a)* and *5 USC Sections 1033 and 1034* this petition for review is properly before this Court. Said petition represents the only pleading on file in the action herein.

IV. ERRORS RELIED UPON BY PETITIONER

1. The rules revisions are not suported by a preponderance of the evidence before the respondent commission.

2. The respondent commission exceeded its jurisdiction to effect the aforesaid rule changes in that it seeks to make changes in the frequencies and times of operation without the consent of the station licensee and without public hearing as provided in USC Title 47 Sections 303 (f) and 316 (a) after request for same.

3. Such rules revisions are in violation of USC Title 47 Section 326 in respect to censorship.

4. Such rules revisions are too vague to be enforceable.

5. Such rules revisions are unconstitutional in that they violate the provisions of the First Amendment of the United States Constitution in regard to freedom of speech.

6. Such rules revisions are arbitrary, capricious and not in the public interest.

7. Such rules revisions deprive the licensees of their property without due process of law in violation of the Fifth Amendment of the United States Constitution.

8. Some of the rules changes are in violation of Section 1002 (a) of the Administrative Procedures Act, USC Title 5, in that they were adopted without the publication required. The striking of Sec. 19.2 (a) of the regulations is an example.

9. That the enforcement of the newly adopted rules will cause petitioner, its members and their licensee members irreparable injury for which there is no adequate remedy at law.

V. STATEMENT OF THE CASE

Petitioner CALIFORNIA CITIZENS BAND ASSOCIATION, INCORPORATED has brought this proceeding in the above entitled Court for review of the Amendment of *Part 19* which are the rules and regulations of the FEDERAL COMMUNICATIONS COMMISSION, now known as *Part 95*, Citizens Radio Service. The aforesaid amended rules became effective April 26, 1965. Petitioner, who participated in the rule making procedures prior to the adoption of the aforesaid rules and regulations is asking the court to set aside the aforesaid Order of the Commission which became effective April 26, 1965, and to remand the matter to the Commission for further proceedings.

The grounds upon which petitioner urges the Court herein to make such action are set forth in Paragraph IV herein.

The petition filed herein contains the following four (4) Exhibits which will be referred to herafter:

"Exhibit A," Notice of proposed Rule Making published November 22, 1962.

"Exhibit B," Proposed Rule Changes of December 21, 1963, which were re-designated from Part 19 to Part 95.

"Exhibit C," Amendments of Part 95 of the Citizens Radio Service published July 31, 1964, to be effective November 1, 1964.

"Exhibit D," Final Order in respect to Proposed Amendments dated February 24, 1965.

For the convenience of the court, petitioner has referred to Exhibits A, B, C and D of the petition rather than to their specific pages in the transcript so it will be unnecesary each time a reference is made for the court to have to labor through the pages of the bulky transcripts; however, for the purpose of designation, if the Court would prefer to use the transcripts the Exhibits can be located as follows:

"Exhibit A" is Vol. I-A, pgs. 3-31, incl.

"Exhibit B," through inadvertance is not included in the transcript.

"Exhibit C," is in Vol. II-D, pgs. 779-826, incl.

"Exhibit D," is in Vol. II-E, pgs. 1080-1099, incl.

VI. THE LAW

1. The Rules Revisions Are Not Supported by a Preponderance Of the Evidence Before the Respondent Commision.

The evidence in the proceedings known as Docket 14843 was originally disclosed to petitioner by respondent commission as consisting of 28 Volumes of let-

ters, comments and petitions filed by interested persons and parties.

Through study of the aforesaid 28 Volumes by the respective counsel for petitioner and respondent commission, the abbreviated record of approximately 1,000 pages was filed with the Court. The reading of the aforesaid transcript will show hundreds of unfavorable comments in respect to the proposed rule making as well as a number of favorable comments. Petitioner has not counted the ayes and nays but believes that the unfavorable material far out-weighs the favorable. A further study of the record shows that most of the letters and other memoranda submitted were merely statements to the effect that they were approved or disapproved without any real explanation; however, there were a few, including petitioner, who set forth reasons, both legal and otherwise, why the amendments should not be adopted as proposed.

The respondent commission obviously did not resort to the aforesaid material received from the American public as its only means for determining the issues involved. Specific attention is drawn to "Exhibit A" wherein on page 11500 therein, the commission stated:

> "2. . . . However, monitoring, inspections and investigations by the Commission as well as numerous letters from licensees complaining of unnecessary interference to their operations

> indicate that misuse of citizens radio station operating privileges is so prevalent in some areas as to threaten the continued usefulness of the service."

On page 10 of "Exhibit D" which is the memorandum of opinion and order made by the Commission, paragraph 18 states:

> "There is one other matter which should be considered. Experience over a period of several years shows that, in a large number of cases, licensees who have been found to be in violation of this rule have, at some time in their exchange of communications, also transmitted communications which are permissible under the rules. However, typically, the great majority of the time involved in such exchange has been for hobbying activities. It is emphasized that such an inter-mixture of permissible communications with prohibited communications cannot justify the transmission of prohibited communications."

In "Exhibit C," under date of July 31, 1964 on page 11099, the commission which refers to miscellaneous amendments of Part 95 states:

> "4. We have reviewed this matter in light of operational experience over several years, as well as the comments filed herein, and reaffirm our determination that the public interest would not be served by permitting hobby type operations in the Citizens Radio Service. The

> rules adopted herein provide a useful and effective communication service for the large number of licensees whose needs may be met only in the Citizens Radio Service."

The foregoing comment was made by the FEDERAL COMMUNICATIONS COMMISSION in respect to hobby type operations.

The commission obviously has used evidence in these proceedings which is now before the Court. In December, 1965, petitioner made its motion requesting the Court herein to make its order requiring respondent Commission to produce the other evidence it relied on in making its decision amending the rules. Said motion was denied without prejudice to renewing the same at the time of the hearing herein. Petitioner feels that the Court now cannot properly determine whether or not there was substantial evidence to sustain the Commission's action.

5 USC 1009 (e) SCOPE OF REVIEW.

> "So far as necessary to decision and where presented the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of any agency action. It shall (A) compel agency action unlawfully withheld or unreasonably delayed; and (b) hold unlawful and set aside agency action, findings, and conclusions found to be (1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with

> law; (2) contrary to constitutional right, power, privilege, or immunity; (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (4) without observance of procedure required by law; (5) unsupported by sustantial evidence in any case subject to the requirements of sections 7 and 8 or otherwise reviewed on the record of an agency hearing provided by statute; or (6) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court. In making the foregoing determinations the court shall review the whole record or such portions thereof as may be cited by any party, and due acount shall be taken of the rule of prejudicial error."

It would therefore seem impossible for the reviewing court to determine whether or not there was substantial evidence to ascertain the Commission's findings as far as the record is concerned herein.

In "Exhibit A" which is *27 FR 11500*, the Commission states on page 11501 as follows:

> "10. . . . All relevant and timely comments and reply comments will be considered by the Commission before final action is taken in this proceeding. In reaching its decision in this proceeding, the Commission may also take into account other relevant information before it, in addition to specific comments invited by this notice."

Demand is again made for the missing evidence so that a full determination can be made. The petitioner also urges that the transcript on file herein does not show substantial evidence necessary to uphold the decision.

Wertz v. *Baldor Electric Company, et al, 337 Federal Reporter, 2d Series, pg. 518* was a case involving a hearing under the Walsh-Healey Act wherein certain material was withheld as being confidential. The Court says on page 527:

> ". . . we have seen no other instance in which such an administrative agency (one in which executive and quasi-judicial functions are merged) has, by adopting rules which provide for tabulations based on secret material within its own possession, created evidence to be used against parties to a controversy before the administrative agency, and has ruled that the evidence cannot be attacked by the ordinary methods of cross-examination.
>
> "We think that this procedure violates the essential canons of fairness laid down by the Supreme Court. . . ."

On page 528, the court further states:

> "Indeed, cases such as (citing cases) suggest strongly that ordinarily the Government cannot take action adverse to a citizen in an administrative decision aimed directly at him or

his group, without disclosing the evidence on which it relies.

"(6) It does not follow, however, that courts will generally force the Government to reveal information it seeks to keep confidential. The Government, in situations of the present sort, has an option; it can hold back confidential material and take the risk of not being able to prove its case, or it can produce the material and allow it to be the subject of direct and cross-examination. There are, of course, occasions when a court will order the Government to break its pledge of confidentiality and produce its files for inspection."

The Court, therefore, set aside the determination of the Secretary on the further ground that it was not supported by reliable, probative, and substantial evidence.

Int. Com. Comm. v. *Louis. & Nash. R.R., 227 US 88.* This was a case of a rate-making procedure in which the Inter-State Commerce Commission had based the rate finding on information that it had previously obtained and which was not presented at the hearing. The Court held that such evidence could not be used in support of the findings made by the Commission because, pg. 93:

". . . such a construction would nullify the right to a hearing,—for manifestly there is no hearing when the party does not know what evi-

dence is offered or considered and is not given an opportunity to test, explain, or refute. . . . In such cases the Commissioners cannot act upon their own information as could jurors in primitive days. All parties must be fully apprised of the evidence submitted or to be considered, and must be given opportunity to cross-examine witnesses, to inspect documents and to offer evidence in explanation or rebuttal. In no other way can a party maintain its rights or make its defense. In no other way can it test the sufficiency of the facts to support the finding; for otherwise, even though it appeared that the order was without evidence, the manifest deficiency could always be explained on the theory that the Commission had before it extraneous, unknown but presumptively sufficient informato support the finding."

2. The Respondent Commission Exceeded Its Jurisdiction to Effect the Aforesaid Rule Changes in That It Seeks To Make Changes in the Frequencies and Times of Operation Without the Consent of the Station Licensee and Without Public Hearing As Provided in U.S.C. Title 47 Sections 303 (f) and 316 (a) after Request for Same.

47 USC 303 (f) states as follows:

"Make such regulations not inconsistent with law as it may deem necessary to prevent interference between stations and to carry out the provisions of this chapter: *Provided, however,* That changes in frequencies, authorized power, or in the times of operation of any station, shall not be made without the consent of the station

licensee unless, after a public hearing, the Commission shall determine that such changes will promote public convenience or interest or will serve public necessity, or the provisions of this chapter will be more fully complied with;"

Also, *47 USC 316 (a) and (b)* states as follows:

"(a) Any station license or contruction permit may be modified by the Commission either for a limited time or for the duration of the term thereof, if in the judgment of the Commission such action will promote the public interest, convenience, and necessity, or the provisions of this chapter or of any treaty ratified by the United States will be more fully complied with. No such order of modification shall become final until the holder of the license or permit shall have been notified in writing of the proposed action and the grounds and reasons therefor, and shall have been given reasonable opportunity, in no event less than thirty days, to show cause by public hearing, if requested, why such order of modification should not issue: *Provided,* That where safety of life or property is involved, the Commission may by order provide for a shorter period of notice.

"(b) In any case where a hearing is conducted pursuant to the provisions of this section, both the burden of proceeding with the introduction of evidence and the burden of proof shall be upon the Commission."

It is quite apparent that from the foregoing, a licensee must have notice in writing of any proposed license modification and an opportunity to show cause by public hearing, if requested, why such order of modification should not issue. From the transcript *Vol. II-C, page 852*, it can be seen that petitioner herein requested a hearing de novo. Also, from the transcript, *Vol. II-C, page 907 and 914*, at least two other parties petitioned for a hearing. No public hearing was ever held. The question now arises as to whether the amendments as proposed would constitute "modification" of the licenses already issued. A license to broadcast has value. The Court states in *L. B. Wilson, Inc.* v. *F.C.C., 170 F2 793* on *page 798:*

> "A broadcasting license is a thing of value to the person to whom it is issued and a business under it may be the subject of injury. We set forth in the margin quotations from decisions of the Supreme Court which support these statements and also provisions of the Communications Act itself which recognize that a broadcasting license confers a private right although a limited and feasible one. . . . And the Supreme Court has ruled that modification (within the meaning of that word as used in the section quoted) of an outstanding license may occur not only directly, by virtue of literal change of its terms, but also indirectly, through extension to another station of broadcasting facilities which will cause interference to the outstanding station within its lawfully protected

contour; and the Court has further ruled that the hearing provided for in the section quoted is required in respect of such indirect modification of an outstanding license as well as in respect of direct modification thereof."

In light of the foregoing decision, it will be necessary to examine the rule changes to see what is being modified. The following are expressly urged as being changes modifying existing licenses:

(a) Limiting interstation communication from 23 to 7 Channels. (Part 95.41 (d) (2)).

(b) Reducing the operating time from 5 minutes operation and 2 minutes of silence to 5 minutes of operation and 5 minutes of silence in interstation communication. (Part 95.91 (b7))

(c) Installing a 150 mile limit on range of operation where none existed before. (Part 95.83 (16h)

(d) Now makes an unincorporated association generally ineligible to hold Class D Station license. (Part 95.1 (13a))

(e) A licensee who is engaged in the business of selling citizens radio transmitting equipment is now prohibited from permitting a customer to operate under his station license. All communications for the purpose of demonstrating such equipment shall consist only of brief messages addresed to other units of the same station. (Part 95.83 (16c))

Also, in respect to the foregoing in *American Broadcasting-Paramount Theatres, Inc.* vs. *F.C.C., 303 F 2nd, p. 766*, the Court states on page 770 (this is a case where no hearing was granted):

> "Even granting the Commission the wide scope to which it is entitled in construing its own rules, we are not now dealing with the former section 312 which concerned the Court in Federal Communications Com. v. WJR, 337 U.S. 265, 278, 279, 69 S. Ct. 1097, 93 L. Ed. 1353 (1949). After that decision came down, Congress amended the Act. The present section 316 is the result. In our view Congress intended to protect the right to be heard—not where a purported issue of no substance is presented, to be sure—but certainly so (1) where no public interest are found to justify an initial grant without hearing and to support the refusal of hearing to an objector as in the circumstances shown here; and (2) where the Commission's claimed "discretion" as to what constitutes modification is so broadly asserted as to read section 316 right out of the Act. We find nothing in the Commission's FM rules permitting the interpretation now asserted. Congress authorized the Commission to promulgate appropiate rules for the conduct of its business, to be sure, but it did not grant the Commission "the congressional power of repeal".

Black's Law Dictionary defines modification as follows:

> "MODIFICATION. A change; an alteration which introduces new elements into the details, or cancels some of them, but leaves the general purpose and effect of the subject matter intact."

Certainly the changes made by the Commission in the operating rights and privileges of the Class D Station licensees constitute modification of an existing license and, therefore, upon request under the statutes, as is the case herein, a hearing should have been granted before the modifications were made effective.

Petitioner feels that in respect to the rules and regulations which became effective April 26, 1965, that there were some promulgated and made effctive that were not published in the Federal Register as required by 5 USC Sec. 1003 which reads as follows:

> "*Rule making.* Except to the extent that there is involved (1) any military, naval or foreign affairs function of the United States or (2) any matter relating to agency management or personnel or to public property, loans, grants, benefits, or contracts—.
>
> "Notice: publication and contents. (a) General notice of proposed rule making shall be published in the Federal Register (unless all persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law) and shall include (1) a statement of the time, place, and

> nature of public rule making proceedings; (2) reference to the authority under which the rule is proposed; and (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved. Except where notice is required by statute, this subsection shall not apply to interpretative rules, general statements of policy, rules of agency organization, procedure, or practice, or in any situation in which the agency for good cause finds (and incorporates the finding and a brief statement of the reasons therefor in the rules issued) that notice and public procedure thereon are impractical, unnecessary, or contrary to the public interest."

"Exhibit A" of petitioner's petition is the notice of the proposed rule making published in *27 FR 11500*, on November 22, 1962.

It is interesting to note that although the proposed rule making published November 22, 1962, made no mention of any limitation of transmission time. *28 FR 14173*, of December 21, 1963, *Sec. 95.81 (f)* limits the transmitting time to 5 consecutive minutes to be followed by a silent period of 2 minutes and reads, as follows:

> "(f) Except in the case of intercommunication between units of the same station, or in the case of communications involving the immediate safety of life, the immediate protection of property, or civil defense communications as pro-

> vided in §95.121, the transmission of any Class D station or any exchange communications between two or more such stations shall not exceed five consecutive minutes and shall be followed by a silent period of at least two minutes in order to provide other stations an opportunity to use the frequency or frequencies involved; during this silent period the station(s) originally transmitting or communicating shall monitor all frequencies involved before any further transmissions are made."

Then in petitioner's petition with "Exhibit C" attached thereto which was published in *29 FR 11099* on July 31, 1964, and which is entitled Part 95 CITIZENS RADIO SERVICE—Miscellaneous Amendments, Sec. 95.81 was deleted and Sec. 95.91 sub. Sec. (b) decreases the operating time and states that after 5 minutes of transmission there be a period of silence of 5 minutes rather than 2 minutes as provided in *28 FR 14173*. Section 95.91 sub. Sec. (b) reads as follows:

> "(b) Communications between or among Class D stations shall not exceed 5 consecutive minutes. At the conclusion of this 5-minute period or upon termination of the exchange if less than 5 minutes, the station transmitting and the stations participating in the exchange shall remain silent for a period of at least 5 minutes and monitor the frequency or frequencies involved before any further transmissions are made. However, for the limited purpose of ac-

knowledging receipt of a call, such a station or stations may answer a calling station and request that it stand by for the duration of the silent period. The time limitations contained in this paragraph may not be avoided by changing the operating frequency of the station and shall apply to all the transmissions of an operator who, under other provisions of this part, may operate a unit of more than one citizens radio station."

3. Such Rules Revisions Are in Violation of U.S.C. Title 47 Section 326 in Respect to Censorship.

47 USC §326 reads as follows:

"*Censorship.* Nothing in this chapter shall be understood or construed to give the Commission the power of censorship over the radio communications or signals transmitted by any radio station, and no regulation or condition shall be promulgated or fixed by the Commission which shall interfere with the right of free speech by means of radio communication."

The following prohibited uses as outlined in 95.83 petitioner urges are in violation of the First Amendment to the United States Constitution and the aforesaid *47 USC 326* and constitute censorship.

"95.83 (a) A Citizens radio station shall not be used:

'(1) For engaging in radio communications as a hobby or diversion, i.e., operating the radio station as an activity in and of itself.

'(4) To carry communications for hire, whether the remuneration or benefit received is direct or indirect.

'(6) For any communication not directed to specific stations or persons, except for: (i) Emergency and civil defense communications as provided in 95.85 (b) and 95.121, respectively, (ii) test transmissions pursuant to §95.93, and (iii) communications from a mobile unit to other units or stations for the sole purpose of requesting routing directions, asistance to disabled vehicles or vesels, information concerning the availability of food or lodging, or any other assistance necessary to a licensee in transit.

'(9) For the direct transmission of any material to the public through public address systems or similar means.

'(10) To transmit superfluous communications, i.e., any transmissions which are not necessary to communications which are permissible.

'(13) For transmitting communications to stations of other licensees which relate to the technical performance, capabilities, or testing of any transmitter or other radio equip-

ment, including transmissions concerning the signal strength or frequency stability of a transmitter, except as necesary to establish or maintain the specific communication.

'(14) For relaying mesages or transmitting communications for a person other than the licensee or members of his immediate family, except: (i) Communications transmitted pursuant to §§ 95.85(b), 95.87(b)(7), and 95.121; and, (ii) upon specific prior Commission approval, communications between citizens radio stations at fixed locations where public telephone service is not provided.

'(15) For advertising or soliciting the sale of any goods or services.

'(16) For transmitting messages in other than plain language. Abbreviations, including nationally or internationally recognized operating signals, may be used only if a list of all such abbreviations and their meaning is kept in the station records and made available to any Commission representative on demand.' "

Petitioner recognizes the fact that certain acts which are criminal in nature such as the use of obscenity and advocating the overthrow of the government by force and violence, as examples, are not protected by *47 USC 326*. Censorship is apparently predicated upon the determination by respondent Commis-

sion that the public convenience, interest or necessity would be served thereby. None of the sections of 95.83 (a) supra have heretofor been defined as criminal acts. Violations of their directives are now criminal and subject to punishment under *47 USC 501 and 502* which read as follows:

> *"47 USC 501:* Any person who willfully and knowingly does or causes or suffers to be done any act, matter, or thing, in this chapter prohibited or declared to be unlawful, or who willfully and knowingly omits or fails to do any act, matter, or thing in this cahpter required to be done, or willfully and knowingly causes or suffers such omission or failure, shall, upon conviction thereof, be punished for such offense, for which no penalty (other than a forfeiture) is provided in this chapter, by a fine of not more than $10,000 or by imprisonment for a term not exceeding one year, or both; except that any person, having been once convicted of an offense punishable under this section, who is subsequently convicted of violating any provision of this chapter punishable under this section, shall be punished by a fine of not more than $10,000 or by imprisonment for a term not exceeding two years, or both."
>
> *"47 USC 502:* Any person who willfully and knowingly violates any rule, regulation, restriction, or condition made or imposed by the Commission under authority of this chapter, or any rule, regulation, restriction, or condition made

> or imposed by any international radio or wire communications treaty or convention, or regulations annexed thereto, to which the United States is or may hereafter become a party shall, in addition to any other penalties provided by law, be punished, upon conviction thereof, by a fine of not more than $500 for each and every day during which such offense occurs."

It is therefore urged that prohibiting the use of certain language on radio and making it a crime for so doing, when normally the use of such language is legal, is censorship in violation of *47 USC 326*.

4. Such Rules Revisions Are too Vague To Be Enforceable.

Ordinarily, penal statutes are strictly construed and cannot be enforced if they are v a g u e and not clearly defined. A person must be certain as to what the law is that he is required to obey.

In "Exhibit C", which is attached to petitioner's petition, respondent Commission uses 6 pages to explain the meaning and intent of the new rules and the reasons for the change. Obviously, the Commission itself realizes that an ordinary individual in reading the rules himself would find many instances in which they would be unintelligible. For example, 95.83 (10) states:

> "To transmit superflous communications, i.e., any transmissions which are not necessary to communications which are permissible."

The question arises as to what are superflous transmissions and what transmissions are not necessary. *95.83 (15)* states:

> "For advertising or soliciting the sale of any goods or services."

What constitutes advertising? If one is in the business of electronic instruments and in the sale and repair of electronic instruments, how far can the businessman go in dealing with customers or potential customers of CB.

Sec. 95.13 states as follows:

> "(a) Subject to the general restrictions of §95.7, any person, other than an unicorporated association in the case of a Class D station, is eligible to hold an authorization to operate a station in the Citizens Radio Service: *Provided,* That if an applicant for a Class A, Class B or Class D station authorization is an individual or partnership, such individual or each partner is eighteen or more years of age or if an applicant for a Class C station authorization is an individual or partnership, such individual or each partner is twelve or more years of age."

Sec. 95.87 (b) sub. Sec. 4 reads as follows:

> "The members, if the licensee is an unincorporated association, provided the communications relate to the business of the association."

It would seem in one breath, the Commission finds an unincorporated association is not eligible for a Class D station license and in the next breath, the members of an unincorporated association which has a Class D license can operate the radio.

In "Exhibit D" *Vol. II-E* states on *page 7* as to vagueness, as follows:

> "*Vagueness.* 13. It is next urged that proposed Section 95.83 (a) (1) is so vague that a licensee cannot reasonably understand which communications are authorized and which are prohibited.
>
> "One petitioner states:
>
> > 'The control of communication cannot be made by rules which are so vague as to make it almost impossible to ascertain the circumstances to which they apply. Where constitutionally valid conditions are imposed on speech by governmental authority, the standards by which one is required to act must be stated in such a way as to be clearly ascertainable . . . the fact that it is difficult to write clear standards does not make valid otherwise invalid regulation. The burden is on the governmental authority to meet the constitutional requirements."

The law is quite clear that statutes cannot be vague and at the same time be constitutional. In *Connally* v.*General Construction Co.* the Court states on *Page 328* as follows:

> "That the terms of a penal statute creating a new offense must be sufficiently explicit to inform those who are subject to it what conduct on their part will render them liable to its penalties, is a well-recognized requirement, consonant alike with ordinary notions of fair play and the settled rules of law. And a statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application violates the first essential of due process of law."

In *Winters* v. *New York, 337 US 507*, the Court states on *page 509:*

> ". . . It is settled that a statute so vague and indefinite, in form and as interpreted, as to permit within the scope of its language the punishment of incidents fairly within the protection of the guarantee of free speech is void, on its face, as contrary to the Fourteenth Amendment. (cites cases) A failure of a statute limiting freedom of expression to give fair notice of what acts will be punished and such a statute's inclusion of prohibitions against expressions, protected by the principles of the First Amendment, violates an accused's rights under procedural due process and freedom of speech or press . . ."

In respect to the word "hobby" which has been defined in *Coffey* v. *Commissioner of Internal Revenue, 141 F 2d, pg. 205*, as follows:

"In his regulations the Commissioner properly recognized the distinction between property operated as a business venture and property used for recreation as a hobby. In the one instance the dominant m o t i v e is the realization of a profit; in the other the objective is pleasure or relaxation, and regular operation at a loss would have little effect upon continued operation. Considering the taxpayer's regular occupation and finacial position, the size and character of the orchard, and the record of its operation over a four-year period, we think the Board correctly concluded that the greater emphasis was upon the cultivation of the orchard as an adjunct to to the country estate, rather than as a business venture. These deductions properly were disallowed.

"The decision of the Tax Court is affirmed."

Thus, under *Part 95* supra, apparently, one can talk about hobbies on CB providing the hobby is not radio; discussing bridge, chess, hunting, etc., are proper but, apparently, not radio.

5. Such Rules Revisions Are Unconstitutional in That They Violate the Provisions of the First Amendment of the United States Constitution in Regard to Freedom of Speech.

The First Amendment of the United States Constitution provides as follows:

"AMENDMENT (I) Congress shall make no law respecting an establishment of religion, or

prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peacably to assemble, and to petition the Government for a redress of grievances."

In respect to the question of freedom of speech, respondent commission in its memorandum opinion and order which is "Exhibit D" herein, cited on pg. 6 of said Exhibit, the case of the *National Broadcasting Company* v. *U.S. 319 US 190 (1943)*. In essence, this case held that the commission had the burden of controlling radio traffic as well as the regulation of engineering and technical aspects. Also, that freedom of utterance is abridged to many who wish to use the limited facilities of radio. Unlike other modes of expression, radio inherently is not available to all. The aforesaid decision concerned rules by the commission which regulated chain broadcasting. Petitioner believes that the aforesaid *NBC* v. *US*, supra can be distinguished from the case herein at bar in several ways. What may have been true in 1943 is not necessarily the case in 1966. The history of radio itself shows a steady advancement over a period of over 60 years from the time Marconi first sent out his feeble signals until the present day wherein we have our complex networks with a very wide spectrum of frequencies. It must be remembered that when Marconi sent out his signal, there was one channel in the whole radio spectrum. Now there are thousands. World War II was very important in the development of radio communication in view of the vital necessities of a war-time period. However, at the time of the National Broadcasting decision in 1943 the Supreme Court, no doubt, had in mind the war-

time atmosphere and the fact that the control and safe-guard of communications was then extremely vital to the national defense; however, at the end of the war, respondent commission conceived the idea of forming the Citizens Radio Band and began to explore its possibilities and to make studies. From that beginning, Citizens Radio Service was formed. In addition, there were formed at least 40 other types of safety and Special Radio Services. These 40 odd services represent almost all of the non-government use of radio other than Broadcast or Common Carrier. In these other services, petitioner is not aware that any are curtailed as the Citizens Radio Service has been in respect to free speech.

95.83 (a) (16), supra, provides a Citizens radio station is prohibiting for transmitting messages in other than *plain* language.

Webster's New World Dictionary defines the word "plain" as follows: 1. flat, level. 2. open; clear: as in plain view. 3. clearly understood, obvious. 4. outspoken; straightforward. 5. Not luxurious. 6. not complicated; simple.

Section 95.83 (a) (16), supra, makes mandatory that licensees use "plain" language in their transmissions. Under the definition of the word "plain" as seen above, the statute might first be attacked for vagueness and, secondly, as being in violation of the First Amendment to the United States Constitution limiting free speech. What is uncomplicated language? Does that mean that a person cannot use technical terms such as might occur when a physician transmits

a message to another doctor advising a course of treatment? A licensee should be able to say anything on the air which he cannot otherwise say publicly. One petitioner states *(Trans. Vol II-A, pg. 852)*.

> "5. It is unthinkable that the FCC should attempt to suppress any discussion of social, political, or religious issues which are not clearly subversive in nature. Gentlemen, our Constitution terms this the right of free speech and guarantees the right of every American citizen to state his personal beliefs by any public means, whether by newspaper, commercial radio, TV, or CB. The radio spectrum is, or should be, in the domain of the people, and that very narrow portion allotted to Class D operation is the only portion left over for the average citizen after all the governmental agencies had taken their requirements. Police it, yes, but not make it prohibitive. We are well aware of the dangers of subversion by all means of communication. But for each subversive agent there are hundreds of thousands of honest, loyal Americans. In restricting the rights of a free people you will be well on the way to achieving their very purposes from within."

The nature of the regulations in general, due in part to the vagueness of some, make it very difficult for a licensee to determine how far he may go in respect in excercising his rights under the First Amendment in respect to freedom of speech. As one petitioner states *(Trans. Vol. II-E, pg. 1065)*:

"II. The Proposed Section 95-83 appears vague, misleading and ambiguous.

> 'a. Although the Citizens Radio Service is authorized for personal communications, it appears that the proposed change attempts to regulate the contents of communications by prohibiting certain communications which are part of a "hobby" or are "intended for diversion." The vaguely worded proposal leaves the licensee in complete uncertainty as to what are permissable communications, and at the same time provides a censorship of individual communications based on value judgements as applied by the individual monitoring activity.
>
> 'b. The determination of a communication as "personal" or non-personal" is highly controversial and is entirely dependent on the circumstances surrounding each specific communication. Any attempt to generalize these into categories or to apply judgemental decisions resulting in citation action, appears to be a dangerous application of censorship. What appears to be a personal conversation to one licensee, would general be classed differently by a non-participant."

6. Such Rules Revisions Are Arbitrary, Capricious and Not in the Public Interest.

Petitioner urges that the rule revisions promulgated by respondent FCC are arbitrary and capricious and not in the public interest.

The California Citizens Band Association which during the course of the proceedings in Docket 14843 incorporated as a non-corporation entitled California Citizens Band Association, Incorporated and is the petitioner herein.

In *Vol. I-E, pg. 449* petitioner filed comments in respect to proposed rule changes. Subsequently, a petition was filed by the said California Citizens Band Association which is contained in *Vol. I-E, pages 515 to 564.* The latter document contained many objections, proposals and discussions concerning the rule changes.

The respondent commission has stated that in respect to the alleged change in the time of operation and of the change of frequency, as follows:

> "Exhibit D", paragraph 26 on pg. 14:
>
> "26. The Commission has concluded that the proposed amendment of Section 95.41 (d) would not change the frequencies available to the petitioners and that proposed Section 95.91 (b) would not change the times of operation of the petitioners' radio stations within the meaning of Section 303(f) of the Act. In any event, even were we to assume, for the purpose of argument, that there has been a change in frequencies and times of operation, a hearing is not required in this case because there are no substantial and material questions of fact presented by the pleadings on these questions but only matters of law and policy."

Such arbitrary action should not be taken wherein the commission merely states that there is no substantial and material questions of fact presented by the pleadings on these questions but only matters of law and policy.

> In *Trans. Vol. I-E, pg. 518*, petitioner states as follows:
>
> ". . . It is significant to note that by far the bulk of the Class D traffic in California, and in most other areas, is so-called inter-communications or communications between units of different stations. This proposed rule making is *not* only *not* an extension or interpretation of the COMMISSIONS original purpose, but is, in addition, discriminatory against the vast majority of the very CITIZENS for which Citizens Radio services in general and Class D service specifically were created. It is only axiomatic that these moves are proposed upon the complaints of a small minority of users and that even those they represent cannot make up a very large segment of those licensees presently active in the Class D service . . . *pg. 520.* In addition, the frequencies allotted for inter-communication are those least capable of bearing the traffic necessary to serve this very useful function. Of the five frequencies proposed, all are notoriously unreliable due to interference from other services and from diathermy equipment. Equipment in Class D service cannot be so finely adjusted, for instance, as to avoid interference from radio diathermy uses."

Referring to *Trans. Vol. I-C, pg. 335*, one petitioner states as follows:

> "Further objection is offered to the first four channels being consecutive in frequency. These four channels will be required to handle 95% of all inter-licensee communications and with the broad band pass of current sets in use today adjacent channel reception is 95% as effective as the channel the receiver is tuned to. The Class D licensee has learned from experience that consecutive channel operation is impractical except with a good dual conversion receiver whereby co-channel interference is minimized. We respectfully suggest that the Commission review this section with some consideration toward a more equitable division of channels for both inter-licensee and intra-licensee communication, also a spreading of the channels for inter-licensee communication."

Certainly the foregoing comments in respect to limiting the frequency herein, interstation communication raises substantial questions of fact in regard to interference.

As another example, we are concerned with the broadcasting time requirements set forth in 95.91 (b) supra. It should be obvious that different radio districts in the United States present different problems in regard to use of the Citizens Radio Service. In the heavily populated metropolitan areas, it is easy to see the need because of the traffic congestion. A silent period is desirable in order to give more licensees the opportun-

ity of using the air; however, in rural and sparsely populated areas where public telephone service is less accessible, the silent period should not have to be of the same duration as that prescribed for the metropolitan areas. Many farmers, ranchers and small town businesses utilize Class D Citizens Radio Service quite extensively in their operations. However, in the smaller populated areas, the air waves are not as jammed as in the heavily populated places. It would seem to be a substantial question of fact as to what silent time is necessary in respect to the different areas of our country. There is no sense forcing someone to leave the air when the same is unnecessary. For example, in one of the comments, a Maine CBer points out that he works on a coastal vessel which uses CB radio for ship to shore communication. It would seem that forcing ships to observe 5 minutes of silence while on the high seas could result in considerable inconvenience and possible danger. Another question of fact to be considered is antenna height. There were many comments protesting new restrictions on antenna structures. *95.37 (c)* provides:

> "An antenna at a fixed location to be used by Class B, Class C, or Class D mobile station shall not exceed 20 feet in height above any man-made structure or natural formation on which it is mounted, except that when mounted on an existing antenna structure of another station the antenna shall not exceed the height of that antenna structure."

19.25 (a) (1), the old rule, provided as follows:

> "The antenna structures proposed to be erected will exceed an overall height of 170 feet above ground level, except where the antenna is mounted on top of an existing man-made structure, other than an antenna structure, and does not increase the overall height of such man-made structure by more than 20 feet;"

As can be seen under the new rule, antenna height has been drastically reduced.

One petitioner states in *Trans. Vol. I-C, pg. 306, as* follows:

> "(1) *Paragraph 19.25.* Limitations on Antenna Structures. A twenty foot height seems to be a very arbitrary ruling, and discriminatory in many cases. Many of us are located in terrain such that this makes our radios unworkable for a large portion of our problems. Most authorities agree that the *minimum* height above ground for effective ground wave coverage is one wave length. One wave length, as you know, is much longer than 20 feet. We who live in remote isolated areas, much of which is rugged terrain, believe that this ruling effectively limits the uses of our radios contrary to the purpose of the citizens radio service and good public policy and we strongly object to this amendment. We urge, rather, that antenna height limitations be raised, rather than lowered."

Certainly antenna height raises a substantial question of fact as to what is needed in the different areas.

In rural areas a rancher might need the 150 miles range for effective use of his CB equipment. It is a question of fact as to what limitations should be on antenna heights. The aforesaid rancher would certainly need greater antenna height than the CBer who lives in the thickly populated areas. Placing such a limitation as the new rule provides, without any evidentiary hearings, is certainly arbitrary and capricious.

Section 19.1 (a) of the old rules, in effect prior to April 26, 1965, which was entitled basis and purposes and which read as follows:

> "Definitions of services. *Citizens Radio Service.* A radio communications service of fixed, land, and mobile stations intended for personal or business radio-communication, radio signalling, control of remote objects or devices by means of radio, and other purposes not specifically prohibited in this part. *Fixed service.* A service of radio-communication between specified fixed points.
>
> *Mobile service.* A service of radiocommunication between mobile and land stations or between mobile stations."

was not referred to in any way or manner whatever in the proposed notice of rule making which is "Exhibit A" of petitioner's petition and no notice whatever of an intent to amend the purposes and basis of Part 19, as expressed in 19.1, now 95.1 which was given. *95.1* reads as follows:

"Basis and purpose. The rules and regulations set forth in this part are issued pursuant to the provisions of Title III of the Communications Act of 1934, as amended, which vests authority in the Federal Communications Commission to regulate radio transmissions and to issue licenses for radio stations. These rules are designed to provide for private short-distance radiocommunications service for the business or personal activities of licensees, for radio signalling, for the control of remote objects or devices by means of radio; all to the extent that these uses are not specifically prohibited in this part. They also provide for procedures whereby manufacturers of radio equipment to be used or operated in the Citizens Radio Service may obtain type acceptance and/or type approval of such equipment as may be appropriate."

This limitation in respect to the other purposes which were previously lawful was done arbitrarily and capriciously and not in the public interest in that there is no evidence in the record to warrant such a change. Petitioner urges that the above cited rule changes were not duly made in that there is no substantial evidence in the record to substantiate the changes.

7. Such Rules Revisions Deprive the Licensees of Their Property Without Due Process of Law in Violation of the Fifth Amendment of the United States Constitution.

Petitioner herein urges that the action of the respondent commission complained of herein deprives its

licensee subsidiary members of their property without due process of law in violation of the due process clause of the Fifth Amendment to the United States Constitution. The aforesaid deprivation is based on five grounds which are specified as follows:

(1) Rules were promulgated without due notice as required by law.

(2) Rules were promulgated without a hearing as required by law.

(3) Rules were promulgated which were arbitrary.

(4) Rules were promulgated which were in the form of a bill of attainder.

(5) Evidence was used which was not made known to petitioner.

In regard to (1), petitioner will develop its contentions in Paragraph 8 of the specification of errors which will follow immediately. In regard to (3), petitioner has already discussed the same in Paragraph 6 of the specifications of errors herein.

In regard to specification (2) above, supra, *Title 5 USC Sec. 1003*, provides that general notice of the proposed rule making shall be published in the Federal Register and either the terms or substance of the proposed rule or a description of the subjects and issues involved.

In addition, *47USC, Sec. 301 states as follows.* "It is the purpose of this chapter, among other things, to maintain the control of the United States over all the channels of interstate and foreign radio transmission; and to provide for the use of such channels, but not the ownership thereof, by persons for limited periods of time, under licenses granted by Federal authority, and no such license shall be construed to create any right, beyond the terms, conditions, and periods of the license. No person shall use or operate any apparatus for the transmission of energy or communications or signals by radio (a) from one place in any Territory or possession of the United States or in the District of Columbia to another place in the same Territory, possession, or District; or (b) from any State, Territory, or possession of the United States, or from the District of Columbia to any other State, Territory, or possession of the United States; or (c) from any place in any State, Territory or possession of the United States, or in the District of Columbia, to any place in any foreign country or to any vessel; or (d) within any State when the effects of such use extend beyond the borders of said State, or when interference is caused by such use or operation with the transmission of such energy, communications, or signals from within said State to any place beyond its borders, or from any place beyond its borders to any place within said State, or with the transmission or reception of such energy, communications, or signals from and/or to places beyond the borders of said State; or (e) upon any ves-

sel or aircarft of the United States; or (f) upon any other mobile stations within the jurisdiction of the United States, except under and in accordance with this chapter and with a license in that behalf granted under the provisions of this chapter."

Also, *47 USC Sec. 303 (f)* states:

"Make such regulations not inconsistent with law as it may deem necessary to prevent interference between stations and to carry out the provisions of this chapter: *Provided, however,* That changes in the frequencies, authorized power, or in the times of operation of any station, shall not be made without the consent of the station licensee unless, after a public hearing, the Commission shall determine that such changes will promote public convenience or interest or will serve public necessity, or the provisions of this chapter will be more fully compiled with."

Petitioner again refers to *47 USC Sec. 316* which requires a hearing for modification of a license.

Admittedly, herein the respondent Commission did not hold public evidentiary hearings in regard to the proposed rule amendments before their adoption. The respondent Commission contends that everyone had an opportunity of being heard, that there were no substantial or material questions of fact to warrant a hearing and that limitations of interstation communication from 23 channels to 7 and the increase of

silence time from 2 to 5 minutes after 5 minutes of transmission did not constitute modification of existing licenses requiring a hearing under *47 USC 303 (f) and 316.* In addition, there were other changes which occurred which will be discussed in the next specification of error.

A broadcasting license is a thing of value to the person to whom it is issued and a business under it may be the subject of injury. A broadcasting license confers a private right although a limited and defeasible one. The Supreme Court has ruled that a modification of an outstanding license may occur not only directly, by virtue of literal change of its terms, but, also, indirectly through extension to another station of broadcasting facilities which will cause interference to the outstanding station within its lawfully protected contour. The Court has further ruled that the hearing provided for is required in respect of such indirect modification of an outstanding license as well as in respect of direct modification thereof. See *C. B. Wilson, Inc.* v. *FCC, 170F2 793*, supra.

2 Am. Jr. 2nd, pg. 197 states:

> "The Federal Administrative Procedure Act provides except as statutes otherwise provide, the proponent of a rule or order in an adjudication type hearing has the burden of proof."

In the cases of *Morgan* v. *U.S.*, which were reported in *298 US 468 and 304 US 1*, the Court held that due

process required the necessity of maintaining a full and fair hearing with the rights of the appellants to have a reasonable opportunity to know the claims advanced against them as shown by the findings proposed by the Bureau of Animal Industry. The maintenance of proper standards on the part of administrative agencies in the performance of their quasi-judicial functions is of the highest importance and in no way cripples or embarrasses the excercise of their appropriate authority. If upon the facts alleged, the "full hearing" required by the statute was not given, petitioners were entitled to prove the facts and have the secreatry's order set aside. Nor is it necessary to go beyond the terms of the statute in order to consider the constitutional requirement of due process as to notice and hearing. For the statute itself, demands a full hearing and the order is void if such a hearing was denied.

2 Am. Jur 2nd, 195 states as follows:

> "Administrative agencies frequently do and ought to conduct independent investigations as a means to the excercise of intelligent action, and they are not bound as is a court to acquire information concerning matters involved in the proceedings before it entirely from the evidence produced. This is held as to administrative determinations which are not quasi-judicial in character or for which no hearing is required. The same holding has been made as to proceedings generally regarded as adjudi-

catory or quasi-judicial in nature, but as to such proceedings it is generally held that even though an administrative authority has statutory power to make independent investigations, it is improper for it to base a decision or findings upon facts so obtained, unless such evidence is introduced at a hearing or otherwise brought to the knowledge of the interested parties prior to decision, with an opportunity to explain and rebut. An administrative agency may make use of reports and data gathered by members of its own staff or outside investigators or investigating bodies or reports of advisory panels, but generally cannot properly base its decision or findings upon facts so obtained, unless such evidence is introduced at a hearing or otherwise brought to the knowledge of the interested parties prior to decision with an opportunity to explain and rebut. An administrative agency may make use of reports and data gathered by members of its own staff or outside investigators or investigating bodies or reports of advisory panels, but, generally cannot properly base its decision and findings upon such reports without introducing them in evidence so as to afford interested parties an opportunity to meet them." See *U.S.* v. *Abilene & So. Ry. Co. 265 US 275, 389.*

It is also urged that the Article I Sec. 8 of the U.S. Constitution provides that Congress shall pass no bill of attainder Petitioner urges that the sanction and

punishment provided in *47 USC 501, 502, 510* violates the aforesaid Article I Sec. 8 of the U.S. Constitution.

8. Some of the Rules Changes Are in Violation of 5 USC 1002 (a) in That They Were Adopted Without the Publication Required.

5 USC 1002 (a) reads as follows:

"Except to the extent that there is involved (1) any function of the United States requiring secrecy in the public interest or (2) any matter relating solely to the internal management of an agency—

(a) Every agency shall separately state and currently publish in the Federal Register (1) descriptions of its central and field organization including delegations by the agency of final authority and the established places at which, with methods whereby, the public may secure information or make submittals or requests; (2) statements of the general course and method by which its functions are channeled and determined, including the nature and requirements of all formal or informal procedures available as well as forms and instructions as to the scope and contents of all papers, reports, or examinations; and, (3) substantive rules adopted as authorized by law and statements of general policy or interpretations formulated and adopted by the agency for the guidance of the public, but not rules addressed to and served upon named persons in accordance with law. No person shall in any manner be required to resort to organization or procedure not so published."

5 USC 1003 (a) requires publication:

> "Except to the extent that there is involved (1) any military, naval, or foreign affairs function of the United States or (2) any matter relating to agency management or personnel or to public property, loans, grants, benefits or contracts—"

The following sections of Part 19 were amended without benefit of publication:

19.1 now *95.1* entitled Basis and Purpose was not referred to in the Notice of Proposed Rule making (Exhibit A) which was published in the Federal Register on November 22, 1962. This omission has already been discussed in section 7 of the assignment of errors herein.

19.2 (a) stated as follows:

> "Citizens Radio Service. A radio communications service of fixed, land, and mobile stations intended for personal or business radiocommunication, radio signalling, control of remote objects or devices by means of radio, and other purposes not specifically prohibited in this part."

The aforesaid definition was deleted without benefit of publication and 95.3 (a) adopted which reads as follows:

> "Citizens Radio Service. A radiocommunications service of fixed, land and mobile stations in-

tended for short-distance personal or business radiocommunications, radio signalling, and control of remote objects or devices by radio; all to the extent that these uses are not specifically prohibited in this part."

In studying the aforesaid change, it is obvious the respondent Commission imposed severe limitations upon the rights and privileges the licensees, including those of petitioner, formerly enjoyed. Such limitation should not be permitted to remain when the agency failed to follow the statutory requirements.

95.3 (c) gave a new interpretation to "man-made structure" by defining the same as meaning "any construction other than a tower, mast or pole." Previously that had been no such limitation in 19.25 (2) (c). This latter change will in all probability have a serious effect on those class D licensees who live in remote areas and consequently require greater antenna height to be to efficiently operate their class D radio equipment.

These examples of rule making without conforming to the legal requirements result in damage to the licensees of petitioner.

9. The Enforcement of the Newly Adopted Rules Will Cause Petitioner, Its Members and Their Licensee Members Irreparable Injury for Which There Is No Adequate Remedy at Law.

Petitioner will briefly point out to the Court that its members and their members have spent thousands

of dollars for CB equipment. The reasons given for the drastic rule changes are that there is now too much abuse of the privilege and that the band is overcrowded. In regard to the former, there is no reason why the great majority should have to suffer for the misdeeds of the few. In respect to the latter, open a few more frequencies to the citizens radio service which are now available. The average CBer has no defense against improper rule making by the respondent commission. The privileges afforded to him by his license are whittled away without due process of law and he has no legal redress. The Court herein should act to prevent the irreparable injury.

VII. CONCLUSION

In conclusion, it is urged that for the reasons heretofore stated, that the Court herein set aside the rules promulgated by respondent commission effective April 26, 1965 and remand the case to the respondent commission so that full hearing may be had.

Dated at Oakland, California, August 4, 1966.

Respectfully submitted,

SEA & HANNA

Attorneys for Petitioner

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Donald M. Sea

IN THE UNITED STATES COURT OF
APPEALS FOR THE NINTH CIRCUIT

NO. 20,030

CALIFORNIA CITIZENS BAND ASSOCIATION,
INCORPORATED, a corporation,
Petitioner,

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA,
Respondents.

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ON PETITION FOR REVIEW OF A REPORT AND
ORDER AND MEMORANDUM OPINION AND ORDER
OF THE FEDERAL COMMUNICATIONS COMMISSION

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IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 20,030

CALIFORNIA CITIZENS BAND ASSOCIATION, INCORPORATED, a corporation,
Petitioner,

v.

FEDERAL COMMUNICATIONS COMMISSION and UNITED STATES OF AMERICA,
Respondents.

ON PETITION FOR REVIEW OF A REPORT AND ORDER AND MEMORANDUM OPINION AND ORDER OF THE FEDERAL COMMUNICATIONS COMMISSION

BRIEF FOR RESPONDENTS

JURISDICTIONAL STATEMENT

This petition was filed pursuant to Section 402(a) of the Communications Act of 1934, as amended, 47 U.S.C. 402(a). It seeks review of a Report and Order released July 29, 1964, (R. Vol. II-C, pp. 779-826) 29 Fed. Reg. 11099, adopting certain amendments to part 19 (now part 95) of the Commission's Rules, and from a Memorandum Opinion and Order released on March 1, 1965, (R. Vol. II-E, pp. 1080-1099), 30 Fed. Reg. 2706, in which the Commission, on reconsideration, adhered to its earlier determination. The jurisdiction of this Court rests on Section 402(a) of the Communications Act, as amended, 47 U.S.C. 402(a), and the Judicial

Review Act, 5 U.S.C. 1031-1042. Venue in this judicial circuit is based on 5 U.S.C. 1033.

COUNTERSTATEMENT OF THE CASE

Because petitioner's statement of the case is incomplete and misleading it is felt that the Court would be assisted by a counterstatement.

The Citizens Radio Service is one of a number of "Safety and Special Radio Services" that have been established by the Federal Communications Commission. Other such services include, e.g., Marine, Aviation, Industrial, Amateur, and Public Safety. These services involve nationwide and international uses of radio by persons, businesses, state and local governments and other organizations licensed to operate communications systems for their own use as an adjunct to their primary business or other activity. 31 Fed. Reg. 6831, 6832 (1966)

The orders under review deal with the promulgation of rules affecting the Citizens Radio Service, particularly as they relate to the kind of messages that may be transmitted, the frequencies that may be used and the length of time prescribed for transmissions and for intervals between transmissions. We think it would be useful as part of this Counterstatement to trace in summary fashion the development of this service from its origin in 1945. We will then turn to the immediate facts which gave rise to this appeal.

Background. The Citizens Radio Service originated in 1945 when the Commission, after a series of extensive inquiries and hearings, allocated a portion of the radio spectrum (460-470 mc/s) for a new "Citizens Radio-communications Service." 10 Fed. Reg. 901. It was pointed out at that time that while the possible uses of the Citizens Radio Service were "as broad as the imagination of the public and the ingenuity of equipment manufacturers could devise," this new service was primarily designed for both personal and business uses of private citizens, particularly where other means of communication were not available. It was intended for essential, local communications such as those entailed in the operation of department stores, farms and construction projects. See Federal Communications Commission Annual Report p. 68. (1945).

On October 23, 1947 the Commission adopted new technical rules designed to provide, inter alia, for private short range radio communication with minimal licensing requirements. 12 Fed. Reg. 7081. The licensing and administrative procedures for the new service were adopted on March 31, 1949. 14 Fed. Reg. 1596. Originally, limitations on usage were kept at a minimum in order to foster development of the service. However, when the rules were codified in 1949, certain prohibitions on the types of communications allowed in the Citizens Radio Service were set forth. Section 19.59, 14 Fed. Reg. 1599, required, e.g., that each station communicate only with other stations in the Citizens

Service; that all communications should be limited to the minimum practicable transmission time, and that no station could be used to carry communications for hire or in connection with radio broadcasting.

In 1958, the Commission revised the rules and established a new class of station (Class D) which was authorized to operate on certain frequencies in the 27 megacycle band.[1/] This new category of station was created to fulfill an apparent and increasing need for short-distance voice communication by radio for personal or business use. 23 Fed. Reg. 6128. Until this time the Citizens Service was relatively free of enforcement problems, but with the allocation of the 27 mc band and the creation of the Class D category, the Commission's difficulties began. See 27 Fed. Reg. 11,500 (1962).

Because the 27 mc band has sporadic long distance transmission characteristics, thus enabling a licensee to make contacts with other stations at great distances from his home base, and because equipment for operation of a Class D station in this range of frequencies was cheaper and simpler than equipment for the other classes of citizens stations, an ever increasing number of applicants

1/ There are three other classes of stations in the Citizens Service Class A, B, and C. 47 CFR 95.3(b) (1966). Each of these categories of stations has different kinds of authorized operation on different frequencies. 47 CFR 95.6 (1966). For purposes of this case, however, only Class D stations, which are more than 90% of the total number at present, need be considered.

applied for Class D licenses. Eligibility standards were low, with an applicant being required only to be a United States citizen, 18 years of age or older. No examination was required, nor was any technical knowledge by the applicant needed. See 47 CFR 95.7 and 95.13 (1966). Within a year, approximately 15,000 Class D station licenses had been granted (of approximately 50,000 Citizens Service licenses overall).

On July 22, 1959, the Commission began a proceeding looking toward amendment of its rules dealing with permissible communications in the Citizens Service, 24 Fed. Reg. 6059. This action was prompted by an awareness that a substantial number of Class D station licensees were engaging in hobby-type activities, lengthy transmissions of idle chatter, and long distance contacts, commonly called "skips," all contrary to the original purpose and intent of the Citizens Radio Service. It was the Commission's view that such communications were inimical to the public interest since they resulted in intolerable interference to those licensees who had a definite and legitimate need for short distance radio communication and who restricted their use of the allocated frequencies to purposes permitted by the rules. In adopting the new amendments, 25 Fed.Reg. 1408 (1960) the Commission spelled out in detail the types of operations which would be permitted and expressly stated that hobby-type communications were contrary to the purposes of the Service and must be prohibited.

The rules, as adopted, reflected the Commission's intention that citizens radio communications generally be used for intercommunications between units of a single station, rather than for communications with other Class D stations or stations operating under other parts of the Commission's rules, and that they be restricted to useful and substantive messages related to the business or personal activities of the individuals concerned. (25 Fed. Reg. 1411). Also, communications from Class D stations were required to be addressed to specific persons or stations at short distances; communications to random or unknown stations were prohibited; and a duration was placed on the length of the communication. Ibid.

In denying petitions to reconsider these prohibitions the Commission again pointed out that the use of a citizens radio station as a hobby, or for the amusement of the operator, was entirely inconsistent with the original purpose of the Citizens Radio Service, and was therefore not authorized. 19 Pike & Fischer, R.R. 1554 (1960). And since 1959, Class D authorizations issued by the Commission have normally been accompanied by information bulletins stressing this fact.

The Present Proceeding. By November, 1962, there were 310,000 Class D licenses outstanding, comprising about 84% of the entire Citizens Radio Service. Increased misuse of the Service prompted the Commission to consider a further amendment to the rules, and in November 1962, another Notice of Proposed Rule Making was issued.

(R. Vol. I-A, pp. 3-31). The new proposal was designed, inter alia, to enunciate even more clearly the prohibited and permissible uses of the Citizens Service in accordance with its original purposes. At this time the Commission pointed out that the widespread abuse by licensees of operating privileges, if left unchecked, would inevitably destroy the utility of the Service.

In response to the Notice over 2,500 comments, representing many divergent views, were received and analyzed by the Commission. The views of those who urged that the rules be liberalized and that hobby-type communications be permitted were carefully considered. But only July 29, 1964, a Report and Order was issued adopting the new rules and reaffirming the Commission's earlier determination that the use of these frequencies must be confined to essential business and personal communications (R. Vol. II-C, pp. 779-826). The Commission's opinion states:

> There are many reasons why the public interest would not be served by opening the Citizens Radio Service to hobby type use, the principal one of which is that, because of the limited number of frequencies available, it is essential that the most effective and productive use for public purposes must be made. Hobbying is not consistent with such purposes. However, there is a need by a substantial segment of the public for radiocommunication for business and personal needs within the purview of the rules as adopted herein. Further, the very nature of hobby type communications is such as to generate greater use of the frequencies to the substantial detriment of other more purposeful uses. Moreover, it seems clear that the use of frequencies for hobby type purposes, if permitted, would generate

> additional usage far beyond the limits of frequencies now available.
>
> In this connection, a number of comments urged that hobbying be permitted in the Citizens Radio Service because it would provide encouragement to young people to increase their technical knowledge and perhaps make a career in electronics and other scientific fields. While these are laudable objectives, they can be accomplished in the Amateur Radio Service where existing rules provide for that type of use. (Footnote omitted.)(R. Vol. II-C, pp. 780-781; 29 Fed. Reg. 11,100 (1964) .

A new section was added to the rules which elaborated on the more important prohibited uses of the Citizens Service, including the use of the service for engaging in radio-communications as a hobby or diversion. Thus, operation of the stations as an activity in and of itself was now expressly prohibited.[2/] 47 CFR 95.83(a)(1) (1966). A provision also made it clear that discussions by licensees of signal strength and frequency stability reports, with exceptions, were specifically prohibited, inasmuch as the Commission ascertained that many violations had involved a hobby-type discussion about the technical performance of the kind of radio equipment being used. 29 Fed. Reg. 11,103; 47 CFR 95.83(a)(13) (1966).

2/ Since the majority of abusesof station operating privileges occurred during communications between stations of different licensees, 7 specific frequencies out of 23 frequencies were reserved exclusively for interstation communication in order to facilitate enforcement. However, all licensees communicating with units of their own station (intrastation) could use any of the 23 frequencies reserved for Class D usage. 29 Fed. Reg. 11,101; 47 CFR 95.41 (1966). Moreover, the new rules limited the duration of communications, 47 CFR 95.91 (1966), and prohibited communications with other units more than 150 miles away. 47 CFR 95.83(b) (1966).

The Commission also rejected the contention that the proposed rules would be in violation of Section 326 of the Communications Act, as amended, 47 U.S.C. 326, and were an unconstitutional abridgment of "freedom of speech":

> Section 303(a) and (b) of the Communications Act authorize the Commission, as the public convenience, interest or necessity requires to classify radio stations and prescribe the nature of the service to be rendered by each class of licensed station. The very creation of the Citizens Radio Service and the establishment of the Class D station are founded in this authority. Therefore, each licensee is limited to the service authorized by his license and prescribed by our regulations governing that service. The authority to prescribe the nature of the service perforce includes the authority to spell out the communications and uses that are not permitted. Thus, the rules adopted herein are plainly within the Commission's regulatory authority. (R. Vol. II-C, p. 782; 29 Fed. Reg. 11,100 (1964).

Various parties, including the petitioner herein, requested reconsideration, alleging that the new rules (a) unconstitutionally abridged freedom of speech; (b) constituted censorship in violation of Section 326 of the Communications Act; (c) were unlawful by reason of their vagueness; (d) were arbitrary, capricious, and not in the public interest, primarily because of the failure to provide for hobby-type operations; (e) violated the Communications Act by amending existing licenses without an evidential hearing; (f) violated the Fifth Amendment to the Constitution in that they deprive licensees of the full use of their property without procedural due process; and (g) violated the Administrative Procedure Act

since rule changes were adopted which were not contained in the Notice of Proposed Rule Making.

The Commission considered at length each of these issues. (R. Vol. II-E, pp. 1089-1097). It again emphasized why the rules violated neither the First Amendment nor Section 326 of the Communications Act. As of July 1, 1964, noted the Commission, there were 700,000 holders of Class D citizens licenses, and, manifestly, the available frequencies had to be limited to the most deserving and needful purposes. Relying on Section 303(g) of the Communications Act of 1934, as amended, 47 U.S.C. 303(g) and the Supreme Court's decision in National Broadcasting Co. v. United States, 319 U.S. 190 (1943), the Commission concluded that the specified restrictions were both legal and proper.

Responding to charges of "vagueness", the Commission pointed out that the rules did not substantially alter the policy which had prevailed in the Citizens Service since its inception. Concluding that the rules could be understood by a person of average prudence the Commission nevertheless adopted a "note" setting forth numerous illustrations of prohibited transmissions. (R. Vol. II-E, pp. 1086-1090); see note to 47 C.F.R. 95.83(a)(1).

It was also argued that the amendment to Section 95.41(d) would change the frequencies available to Class D citizens stations and that proposed Section 95.91(b) would change the times of operations and that such changes, without the hearing required by Section 303(f) of the Act or consent of the licensees would be illegal.

The 95.41(d) amendment restricts inter-station transmissions to seven specified frequencies of the 23 available to Class D licensees. Since all 23 channels would remain available for intra-station use, the Commission found that no "change in frequency" such as Section 303(f) [3/] contemplates had taken place.

New Section 95.91(b) would have the effect of lengthening the already existing "silent period" after each transmission from two to five minutes. The Commission concluded that such a change is not a change "in the time of operation" within the meaning of Section 303(f) since the licensee is free to operate, as before, 24 hours a day, [4/] subject as always to limitations resulting from the shared use of the frequencies and to the requirement that the communications be of an essential business or personal nature.

3/ Section 303(f) reads: "Except as otherwise provided in this Act, the Commission from time to time, as public convenience, interest, or necessity requires shall --

* * *

(f) Make such regulations not inconsistent with law as it may deem necessary to prevent interference between stations and to carry out the provisions of this Act: Provided, however, that changes in the frequencies, authorized power, or in the times of operation of any station, shall not be made without the consent of the station licensee unless, after a public hearing, the Commission shall determine that such changes will promote public convenience or interest or will serve public necessity, or the provisions of the Act will be more fully complied with." 47 U.S.C. Section 303(f).

4/ The Commission also considered the allegation that aside from the hearing requirements of Section 303(f), a change in the permissible communications would necessitate a hearing under Section 316 of the Act. It was concluded that the same reasoning which obviated the need for a 303(f) hearing rendered unnecessary a 316 hearing.

In any event, said the Commission, no hearing would be required by Section 303(f) because all petitioners had ample opportunity to supply information and views on the proposed amendments. The information and comments submitted on the new sections by a substantial number of persons were considered by the Commission in reaching its decision. These disclosed no substantial and material factual issues, so that in the Commission's view no useful purpose would be served by an evidentiary hearing. In addition, the Commission pointed out the practical difficulties involved in attempting to effect the changes of this nature by any means other than general rule making in view of the number of licensees involved. (R. Vol. II-E, pp. 1092-95).

The Commission concluded that it had complied with all the pertinent requirements of Section 4 of the Administrative Procedure Act, 5 U.S.C. Section 1003 since all interested persons had had an opportunity to present their views. Sections 7 and 8 of the A.P.A., 5 U.S.C. Sections 1006, 1007 were not applicable, said the Commission, since no statute requires that the rules in question be made on the record after opportunity for an agency hearing (R. Vol. II-E, p. 1096). Also considered and rejected were arguments challenging the constitutionality of the new regulations and the sufficiency of notice of the changes proposed. (R. Vol. II-E, pp. 1096-97).

Following this decision, on April 19, 1965 an appeal was taken to the United States Court of Appeals for the Second Circuit, and at the same time an injunction pendente lite was requested. The Court, however, went immediately to the merits of the case and after argument affirmed the Commission. Lafayette Radio Electronics Corp. v. United States, 345 F.2d 278 (2nd Cir., 1965). The Court found without merit the challenge to the prohibition on hobbying and squarely held that neither Section 326 of the Communications Act nor the First Amendment were violated.. Similarly the Court found "no sufficient force in the claim of unconstitutional vagueness."

On April 26, 1965, the same day that the Lafayette case was decided, in the Second Circuit, this petition for review was filed.

QUESTIONS PRESENTED

In the Commission's view the following questions are presented:

1. Whether the Commission's rules imposing restrictions on the use of certain frequencies assigned to the Citizens Band Service constitute illegal or unconstitutional restrictions on freedom of speech;

2. Whether the rule making procedure followed in this case deprived petitioner of any procedural rights under the Communications Act or the Administrative Procedure Act.

STATUTES INVOLVED

Section 4 of the Administrative Procedure Act, 5 U.S.C. 1003;

Sections 303 (a), (b), (f) and (g), 316, 326 and 405 of the Communications Act of 1934, as amended, 47 U.S.C. 303 (a), (b), (f) and (g), 316, 326 and 405.

Pertinent portions of these statutory provisions are set forth as an appendix hereto.

SUMMARY OF ARGUMENT

Reasonable limitations on the types of communication which may be transmitted on the frequencies allocated to the Citizens Band Service are clearly within the Commission's authority, and are not in conflict either with the First Amendment or with Section 326 of the Communications Act of 1934, as amended, 47 U.S.C. section 326. These frequencies are currently assigned to hundreds of thousands of users, and restrictions on their use are imperative if the maximum efficient use of a scarce resource is to be realized. Lafayette Radio Electronics Corp. v. United States, 345 F.2d 278 (2nd Cir., 1965); National Broadcasting Co. v. United States, 319 U.S. 190 (1943).

Sections 303(a) and (b) of the Communications Act of 1934, as amended, 47 U.S.C. sections 303(a) and (b) empower the Commission to classify radio stations and to prescribe the nature of the service to be rendered by each class. Section 303(g) of the Act, 47 U.S.C. section 303(g), mandating the Commission to "encourage the larger and more effective use of radio" has been held to grant to the Commission authority to impose limitations on the use of the public airwaves. National Broadcasting Co. v. United States, supra.

Petitioner has failed to show that the limitations imposed by the Commission's rules are in any way unreasonable or contrary

to the public interest standard of the Communications Act. Nor are the rules unconstitutionally vague. The present rules work no change in the use to which the Citizen's Band class D service may be put, and the Commission makes every effort to inform licensees of the restrictions on the service.

The Communications Act does not require the Commission to hold evidentiary hearings on individual license modifications before adopting rules of general application to the Citizens Radio Service. Neither section 303(f) nor section 316 of the Act, 47 U.S.C. sections 303(f) and 316 require individual ajudicatory hearings for the kind of rule changes adopted in the proceeding under review here. All affected parties had full opportunity to present their views in a rule making procedure which complied fully with the applicable provisions of the Administrative Procedure Act. It is settled that this kind of procedure is adequate where the promulgation of standards of general applicability is involved, even where a statutory right to a hearing may exist before an individual license may be modified. Federal Power Commission v. Texaco, 377 U.S. 33 (1963); National Broadcasting Co. v. United States, supra; American Airlines v. Civil Aeronautics Board, 359 F.2d 624 (D.C. Cir., 1966); Superior Oil Co. v. Federal Power Commission, 322 F.2d 601 (9th Cir., 1965). There was no denial of due process in the refusal to grant individual hearings. Willapoint Oysters v. Ewing, 174 F.2d 676 (9th Cir., 1949).

Petitioner had adequate notice under the provisions of section 4 of the Administrative Procedure Act, 5 U.S.C. 1003. The Commission's Notice of Proposed Rule Making contained the substance of the proposed rule or a description of the subject and issues involved. The Commission is not required to publish in advance every precise proposal which may ultimately be adopted. Willapoint Oysters, Inc. v. Ewing, supra; Wilson and Co. v. United States, 335 F.2d 788 (D.C. Cir., 1964), cert denied 380 U.S. 950.

The record is adequate to support the action taken by the Commission. Petitioner did not request of the Commission the production of any material now claimed to be wrongfully withheld. The request is therefore not properly before this court. Section 405 of the Act, 47 U.S.C. section 405; Florida Gulf Coast Broadcasters, Inc. v. Federal Communications Commission, 352 F.2d 726 (D.C. Cir., 1965). In any event, there is no requirement that the proceeding attacked herein be held "on the record". Sections 7 and 8 of the Administrative Procedure Act, 5 U.S.C. sections 1006, 1007, on which petitioner relies, are inapposite. It is not necessary in a rule making procedu that the agency submit for the record material which would support it rule making decisions. Flying Tiger Line, Inc. v. Boyd, 244 F. Supp. 889, (D.D.C., 1965), affirmed sub nom. Flying Tiger Line, Inc. v. Murphy, Case No. 19,869 D.C. Cir., decided by Judgment Order issued June 2, 1966. Here the basis for the Commission's action is set forth in the Report and Order adopting the new rules and shows beyond question that the action was a reasonable one.

ARGUMENT

In adopting the rules which are under review in this proceeding, the Commission dealt with a problem of vast proportions. As of April 1965, when the rules became effective, there were more than 800,000 licensees in the Citizens Radio Service, with applications being filed at the rate of approximately 20,000 per month. When the service was established in 1945 its purpose was to provide private citizens with a medium for essential business and personal communications. Twenty years later the Commission reaffirmed its view that the objectives of the Service were still sound. It was increasingly apparent, however, that the service was threatened by widespread and continuous disregard for the applicable rules, particularly the pervasive use of the service for hobbying and "chitchat." The Commission concluded that action had to be taken to clear the airwaves of the clutter which was saturating and destroying the service.

Consequently, the Commission undertook a rule making proceeding pursuant to Section 4 of the Administrative Procedure Act, publishing proposed new rules and soliciting the views of interested members of the public. More than 2,500 comments and petitions were received and analyzed. The Commission carefully considered the many suggestions and alternatives offered by the public, and took into account as well its own experience in the administration of the Citizens Band Service. The result was the 1964 Report and Order (R. Vol. II-C, pp. 779-826) and the 1965 Memorandum Opinion and Order on reconsideration (R. Vol. II-E, pp. 1080-1099) which are under review herein.

Petitioner has challenged the Commission's action on a variety of substantive and procedural grounds. On the merits it urges that the rules impose improper restrictions on freedom of speech, that they are unconstitutionally vague and that they are otherwise arbitrary and unreasonable. Procedurally, it contends that an evidentiary hearing was required before the rules could become effective as to individual licensees; that the notice given was inadequate; and that the Commission erroneously relied on data not included in the comments filed in the rule making. We will show that the Commission action was a reasonable one, lying well within its permitted discretion, and that the proceeding before the agency was in complete accord with the procedures prescribed by statute.

I. IT IS CLEARLY WITHIN THE COMMISSION'S AUTHORITY TO SPECIFY THE USE TO WHICH FREQUENCIES ALLOCATED TO THE CITIZENS RADIO SERVICE CAN BE PUT; AND ITS RULES PLACING REASONABLE LIMITATIONS ON THE KIND OF COMMUNICATIONS WHICH MAY BE TRANSMITTED DO NOT VIOLATE THE FIRST AMENDMENT OR SECTION 326 OF THE COMMUNICATIONS ACT.

There is no merit to petitioner's argument that the new rules, specifically Section 95.83, by prohibiting certain kinds of transmissions, violate the First Amendment and Section 326 of the Communications Act of 1934, as amended, 47 U.S.C. Section 326.[4/] Ruling on substantially the same question the Court of Appeals for the Second Circuit upheld the Commission's contention that the rules

4/ Section 95.83 lists some sixteen kinds of prohibited transmissions. Those petitioner finds objectionable are set forth at pp. 33-35 of its brief. §95.83 is printed in the Appendix attached hereto.

involved no abridgment of the right of free speech:

> [Petitioner's] argument is that in a service available to all citizens for business and personal activities generally, citizens must be allowed to say whatever they please, save for such few restrictions as the First Amendment permits. But this ignores that "Freedom of utterance is abridged to many who wish to use the limited facilities of radio. Unlike other modes of expression, radio inherently is not available to all." National Broadcasting Co. v. United States, 319 U.S. 190, 226 (1943). There are now 700,000 Class D licensees utilizing the 23 available frequencies, and several thousand are added each month. Here is truly a situation where if everybody could say anything, many could say nothing. The very absence of restrictions on the number of users may demand more restrictions on the use. Lafayette Radio Electronics Corp. v. United States, 345 F.2d 278, 281, (1965).

This decision is wholly in accord with other cases construing the Commission's authority in this area and should, we believe, be regarded as controlling here.

Sections 303(a) and (b) of the Communications Act of 1934, as amended, 47 U.S.C. Sections 303(a) and (b) empower the Commission to classify radio stations and to prescribe the nature of the service to be rendered by each class of licensed station. In addition, it has been settled law for many years that the Commission in the exercise of its power to "encourage the larger and more effective use of radio," Communications Act of 1934, Section 303(g), 47 U.S.C. Section 303(g), has the power to impose certain limitations on the use of the public airwaves. Thus, in National Broadcasting Co. v. United States, 319 U.S. 190 (1943), the Supreme

Court rejected a First Amendment challenge to the Commission's chain broadcasting rules, observing that "The facilities of radio are limited and therefore precious;" and "cannot be left to wasteful use without detriment to the public interest." 319 U.S. at 216. Emphasizing (in the language quoted in Lafayette, supra) that radio is not available to anyone who wishes to use it, the opinion states:

> That is its unique characteristic, and that is why, unlike other modes of expression, it is subject to governmental regulation. Because it cannot be used by all, some who wish to use it must be denied. * * * The question here is simply whether the Commission, by announcing that it will refuse licenses to persons who engaged in specified network practices (a basis for choice which we hold is comprehended within the statutory criterion of 'public interest'), is thereby denying such persons the constitutional right of free speech. The right of free speech does not include, however, the right to use the facilities of radio without a license." Id. at 226-227.

The decision also expressly confirmed the Commission's power to restrict use of the airwaves to certain kinds of radio traffic:

> The Act itself establishes that the Commission's powers are not limited to the engineering and technical aspects of regulation of radio communication . . . the Act does not restrict the Commission merely to supervision of the traffic. It puts upon the Commission the burden of determining the composition of that traffic. Id. at 215-216. 5/

In the exercise of this authority, the Commission has created some forty special services of which the Citizens Service

5/ Petitioner's suggestion that overcrowding of the available spectrum space is no longer as serious a problem as it was when NBC was decided is contrary to fact. Overcrowding in the land mobile services (of which the Citizens Service is one) has become so severe in recent years that the Commission has established a special committee to explore possible solutions. 29 Fed. Reg. 4818 (1964); Annual Report of the Federal Communications Commission for 1965, pp. 133, 173. Bendix Aviation Corp. v. Federal Communi-
(cont'd)

is one. These services differ from broadcast and common carrier services in that the allocated frequencies are shared among users rather than assigned on an exclusive basis.[6] Because requests for the limited spectrum space far exceed the available frequencies, the Commission has been forced to establish priorities, limit eligibility to hold licenses, and restrict the use of stations in these services to specified purposes and types of communications which will be most beneficial to the public and assure the most effective uses of the very limited frequency space. For example, the Aviation Radio Service was created to fulfill radio communications requirements in connection with air traffic and related aviation needs, and the rules prohibit messages unrelated to those needs, 47 CFR 87.123. Comparable provisions apply to other services. See, e.g., 47 CFR 91.151; 93.151 and 97.113 et seq. for analogous regulations in the Industrial Radio Service, the Land Transportation Radio Service and the Amateur Service, respectively.

The Class D category in the Citizens Service was created to bring the advantages of radio to the general citizenry for

5/ (cont'd) cations Commission, 272 F.2d 533, (D.C. Cir., 1959), cert. denied sub nom. Aeronautical Radio, Inc. v. United States, 361 U.S. 965, presents an example of the difficult problems still arising from the inadequacy of spectrum space. See also Carter Mountain Transmission Corp. v. Federal Communications Commission, 321 F.2d 359 (D.C. Cir., 1963) cert. denied, 375 U.S. 951 and Idaho Microwave Corp. v. Federal Communications Commission, 352 F.2d 729 (D.C. Cir., 1965) where restrictions on the content of radio transmissions were upheld largely on the authority of NBC.

6/ The vast number of licensees in these services makes it essential that the available frequencies be shared. At the same time sharing represents a feasible arrangement since the legitimate needs of the users are more apt to be intermittent than continuous.

substantive business or personal communications needs. However, more than 800,000 licensees must share the 23 frequencies available. It therefore becomes self-evident, as the Court recognized in Lafayette supra, that heavy restrictions must be placed on the kind of use to which the frequencies may be put. Since the purpose of the Citize Band has never been hobbying or long distance communication, the Commission properly acted to exclude these and other extraneous kinds of transmissions. To act otherwise, the Commission concluded, would be to render the service useless to the large number of licensees whom the Commission has found use the service properly, and who stand in real need of its availability. 7/

The other restrictions about which petitioner complains were in substance a part of the rules prior to the present rule making cf. 25 Fed. Reg. 1411 (1960). Like similar prohibitions in other services, their objective is to keep the use to which the frequencies are put within bounds that are consistent with the purposes for which the service was established. Petitioner has failed to show that these limitations are in any way unreasonable or contrary to the public interest standard of the Communications Act. This

7/ This is not to say that the Commission has prohibited the use of radio as a pastime or hobby. On the contrary, through its Amateur Service, the Commission has authorized and encouraged this kind of activity. And it specifically urged Citizens Band licensees who wished to pursue it to apply for licenses in this service. The rule under review herein simply requires licensees in the Citizens Service to forego the transmission of communications which are inconsistent with the purposes of the Service. In its Report and Order, the Commission noted that conversion of citizens band equipment to amateur use is generally feasible at very modest cost (R. V. II-C, p. 781).

being so, they cannot be regarded as a denial of free speech. National Broadcasting Company v. United States, supra at 227.

The contention that Section 95.83 is unconstitutionally vague is also without merit. This is particularly so when the rule is considered in the framework of the history of Citizens Band regulation and in light of the many Commission efforts to inform Citizens Band licensees of the legal restrictions on the use of their equipment.

In the first place, the rule on its face seems perfectly clear, setting forth some sixteen kinds of prohibited transmissions. Moreover, the rule works no material change in the substantive policy which has prevailed in Citizens Band service since its inception in 1947. As we have shown supra, pp. 3-6, hobbying and other uses unrelated to the licensee's business or personal affairs have never been permitted in the service. Furthermore, each applicant for a license must certify in writing (on his application) that he has read the applicable rules, and understands them. For the past several years, a bulletin has been sent with substantially every new license advising of the permissible uses in this service, and many public notices and bulletins have been issued on the subject. Several decisions of the Commission have dealt with prohibited users.[8/] And public notices of enforcement actions taken by the Commission are regularly mailed to many citizens radio clubs.

It is therefore difficult to accept petitioner's contention

8/ Warren G. Holleman, 34 FCC 121, 23 Pike & Fischer, R.R. 539 (1963); Vincent R. Banville, 35 FCC 604 (1963).

that a licensee who is making a good faith effort to comply with the rules would find their substance unascertainable. In addition, whenever enforcement action is instituted, the licensee is first warned about the transmissions which are in violation of the rules, and given an opportunity to bring his operations into compliance with them.

Arguments similar to petitioner's were squarely rejected by the United States Court of Appeals for the Second Circuit in Lafayette, supra. "The FCC is not to be faulted," said the court, "simply because ingenuity can imagine borderline cases where a conscientious licensee might have fair doubt whether his communications were banned or not." Lafayette Radio Electronics, Inc. v. Federal Communications Commission, 345 F.2d at 281-2 (1965). When the licensee is in doubt, noted the Court, he need only inquire, pursuant to the provisions of 47 CFR 1.2 (1966) which provides for the issuance of declaratory rulings. Moreover, as the Court observed, the sanction of revocation or fine,47 U.S.C. Sections 312, 510 is customarily imposed only after adequate warning and opportunity to rectify the problem save in the most flagrant cases.

In sum, we submit that the rules are clearly comprehensible by a man of average intelligence who is in good faith attempting to adhere to them. They are reasonable on their face and are rationally calculated to serve the public interest; as such they violate neither the First Amendment nor Section 326 of the Act.

II. THE PROCEDURE FOLLOWED BY THE COMMISSION COMPLIED WITH ALL APPLICABLE STATUTORY REQUIREMENTS

A. The Communications Act Did Not Require the Commission To Hold Evidentiary Hearings On Individual License Modifications Before Adopting Rules Of General Applicability To The Citizens Radio Service.

Among the rules adopted was an amendment to Section 95.41(d) and a new Section 95.91(b). Section 95.41(d) as it existed prior to the proceeding here under review assigned 23 frequencies to Class D Citizens Band use. These frequencies were intended primarily for intrastation use, and only secondarily for interstation communication, in conformity with the basic purpose of the Citizens Band Service. Under the amendment, the same 23 frequencies remain available, but interstation use is limited to only seven specified frequencies. Former Section 95.81(f) provided for a maximum transmission length of five minutes with a two minute silent period after each exchange in interstation use. The new Section 95.91(b), retains the five minute limit on transmission, but lengthens the silent period from two to five minutes. In addition, Section 95.83(b) established a firm 150 mile limit on the range of transmissions, and Section 95.13, prohibited unincorporated associations from holding licenses.

These changes, alleges petitioner, violate Section 303(f) of the Communications Act, 47 U.S.C. Section 303(f) which requires that the Commission either obtain a licensee's consent or hold a

hearing before "changes in the frequencies, authorized power, or in the time of operation of any station . . ." can be effectuated. Petitioner also relies on Section 316 of the Act, 47 U.S.C. Section 316, which provides that the holder of a license or permit be afforded a public hearing on request before a modification can be effected in the terms of his license.

The Commission considered these claims in some detail and concluded that under the circumstances a further evidentiary-type hearing was not required (R. Vol. II-B pp. 1092-1095). Essentially it was the Commission's position that the rules did not involve the kind of operating changes contemplated by Section 303(f) but that in any event no evidentiary hearing was required either by that section or Section 316(a) since all affected parties had been afforded the opportunity to submit their views and since no substantial or material questions of fact existed which would warrant exploration in an adjudicatory hearing. In addition, the Commission noted that because of the very large number of licensees in the service it would be "impracticable, if not impossible" to obtain individual consent to the rules or to afford separate hearings. Petitioner has failed to show that this disposition was in any sense unreasonable or contrary to law.

It is clear beyond question that the actions under review in this case were directed not to individual licensees; rather they were remedial and prospective only, of general effect, and

designed to implement broad policy determinations. In every respect, then, they were legislative in character. Like many regulatory actions, they serve to prohibit or restrict activities which might otherwise be performed by licensees, but this does not, as petitioner seems to contend, constitute a modification of operating authority such as to require formal license amendment proceedings.

Licenses issued in the Citizens Service expressly state that the privileges granted are "subject to the provisions of the Communications Act of 1934, as amended, subsequent acts, treaties and all regulations heretofore or hereafter made by the Commission . . ." (Emphasis added.) Essentially, the rules in question here specify more stringent requirements in order to eliminate widespread abuses and to permit all licensees to utilize the frequencies in accordance with the purposes for which the licenses were issued. As such, we believe they represent reasonable restrictions which can be imposed by rule making. Cf. Great Lakes Airlines v. Civil Aeronautics Board, 291 F.2d 354, 367 (9th Cir., 1961) cert. denied, 368 U.S. 890; American Trucking Ass'n. v. United States, 344 U.S. 7[illegible] (1953).

Prior to the adoption of the rules, the Commission held a rule making hearing in full conformance with the procedural provisions of Section 4 of the Administrative Procedure Act, 5 U.S.C. 1003. And it is well settled that this kind of proceeding is adequate where the promulgation of standards of general applicability

is involved even where there may be a statutory right to a hearing before an individual application may be denied or a license modified.[9/] Federal Power Commission v. Texaco, Inc., 377 U.S. 33, (1963); United States v. Storer Broadcasting Co., 351 U.S. 192 (1956); National Broadcasting Co. v. United States, 319 U.S. 190 (1943); American Airlines v. Civil Aeronautics Board, 359 F.2d 624 (D.C. Cir., 1966); Superior Oil Co. v. Federal Power Commission, 322 F.2d 601 (9th Cir., 1965); Airline Pilots Ass'n., International v. Quesada, 276 F.2d 892 (2nd Cir., 1960). Each of these cases involved statutes with hearing requirements substantially the same as those relied on by petitioner here but in each instance it was concluded that "the 'hearing' granted under §4(b) of the Administrative Procedure Act is adequate" to fulfill the statutory requirement. Federal Power Commission v. Texaco, Inc., supra at 39.

In Air Line Pilots Association, International v. Quesada, supra, the court was faced with a challenge similar to petitioner's here. In that case the Administrator of the Federal Aviation Authority had altered the rules affecting the outstanding certificates of air line pilots. Said the court:

9/ Of course, in circumstances where Commission action will affect in a profound way the rights of an individual broadcast licensee, an adjudicatory type hearing is clearly required. See Federal Communications Commission v. National Broadcasting Co. (KOA) 319 U.S. 239 (1943); Cf. Federal Communications Commission v. WJR, The Goodwill Station, 337 U.S. 265 (1949).

> Nor does the regulation violate due process because it modified pilots' rights without affording each certificate holder a hearing. Administrative regulations often limit in the public interest the use that persons may make of their property without affording each one affected an opportunity to present evidence upon the fairness of the regulation. * * * Obviously, unless the incidental limitations upon the use of airmen's certificates were subject to modification by general rules, the conduct of the Administrator's business would be subject to intolerable burdens which might well render it impossible for him effectivly to discharge his duties. All changes in certificates would be subject to adjudicatory hearings, including appeals to the courts, and each pilot whose license was affected - here some 18,000 - might demand to be heard individually. 276 F.2d at 896.

Similarly, in National Broadcasting Co. v. United States, 319 U.S. 190 (1940), the Supreme Court sustained the validity of the "chain broadcasting" regulations which were adopted, without adjudicatory hearings, in the middle of the current license terms. Many licensees were thereby affected in ways far more profound than is the instant petitioner. But the Court held that the Commission had the right, and the duty, to issue regulations in the public interest.

And in the recent case of American Airlines v. Civil Aeronautics Board, 359 F.2d 624 (D.C. Cir., 1966) the Court of Appeals for the District of Columbia upheld a CAB rule making procedure whose effect was to withdraw from combination (cargo and passenger) carriers, the right to offer certain "block space" reduced cargo rates to shippers, notwithstanding a provision of

the Federal Aviation Act[10] which required a hearing of an adjudicatory nature before an outstanding certificate could be modified. The Court found that since the regulation in question was legitimately general in nature, the certificate holders were entitled to no more procedural protection than that provided by a rule making hearing pursuant to Section 4 of the Administrative Procedure Act, 5 U.S.C. Section 1003. In supporting the CAB's reliance on rule making the Court noted that Congress had given the Board not only a wide regulatory authority, but also a specific promotional function to initiate proposals for the purpose of expanding efficient civil aviation transportation, the power to classify carriers and service, and the power to issue implementing rules and regulations.[11] The Federal Communications Commission operates under similar statutory mandates.[12]

As in Quesada, the Court made clear that adjudicatory hearings are unnecessary when the modification takes place not as a particularized action against an individual licensee, but as a consequence of a bona fide rule, whose purpose is to affect a large

10/ Section 401(g) of the Federal Aviation Act, 49 U.S.C. Section 1371(g).

11/ See 49 U.S.C. Sections 1302(f), 1354(a), 1386(a).

12/ See Communications Act of 1934, as amended, Sections 303(a), (b), (f), (g), (r), 47 U.S.C. Sections 303(a), (b), (f), (g), and (r).

class of licensees in furtherance of the public interest.[13] In such a case, a licensee is entitled only to notice, and an opportunity to submit his views and have them considered. Petitioner has been afforded these rights and there is nothing in the language or legislative history of Sections 303(f) and 316 to indicate that more is required.[14]

Here, as we have pointed out, the regulations affect a class of licensees numbering in the hundreds of thousands. After exhaustively examining and evaluating the mass of material filed with it, the Commission had the benefit of every possible point of view, and every kind of factual data which might have some relevance to the issues. All that remained were the policy determinations, i.e., questions of law. There were no substantial or material questions of fact in the resolution of which an evidentiary hearing would be useful. Cf. National Broadcasting Company v. Federal Communications Commission, __ F.2d __, D.C. Cir., Case No. 19,523, decided May 26, 1966; Capital Broadcasting Co. v.

13/ The same Court has recently reaffirmed this view in Flying Tiger Line, Inc. v. Murphy, Case No. 19,869, affirming a District Court opinion which rejected a contention that the CAB had wrongfully deprived Flying Tiger of certain privileges without the adjudicatory hearing required by law. D.C. Cir., Per Curiam Judgment dated June 2, 1966.

14/ Discussing approvingly the use of rule making procedures wherever possible, the Court in American Airlines, supra, noted that "(S)uch rule making is not to be shackled, in the absence of clear and specific Congressional requirement, by importation of formalities developed for the adjudicatory process and basically unsuited for policy rule making." 359 F.2d at 629.

Federal Communications Commission 367 F.2d 592 (D.C. Cir., 1963). Significantly, petitioner does not inform this Court what further matters it wishes to raise in the requested hearings, and there is nothing in the record to indicate that a hearing might produce further useful evidence.

Nor has petitioner been deprived of any constitutional rights of due process of law. As we have shown above, petitioner had every procedural opportunity to which it was entitled in a valid rule making procedure. It is settled that the Constitution does not require more. Bi-Metallic Investment Co. v. State Board of Equalization, 239 U.S. 441, 445 (1915). See Superior Oil Co. v. Federal Power Commission, supra, at 614-617; Willapoint Oysters v. Ewing, supra, at 692-694.

In sum, there is no question as to the Commission's substantive authority to specify the frequencies, time of operation, etc. of Citizens Service licensees. Nor have special circumstances been alleged which would warrant waiver of the rules. Under similar circumstances this Court has held that affected persons are no more entitled to an evidentiary hearing on the merits of a regulation than would have been the case if the adopted standard had been expressed in the statute rather than by rule. Superior Oil Co. v. Federal Power Commission, 322 F.2d at 619. Clearly the same result should obtain here.

B) Petitioner Had Adequate Notice Of The Substance Of The Proposed Rules.

It is argued (Petitioner's Br., pp. 59-61) that the Notice of Proposed Rule Making in this case was inadequate in that it failed to inform petitioner of the amendment to Section 95.1 as finally adopted, and made other changes without proper notice.

Section 4(a) of the Administrative Procedure Act, 5 U.S.C. section 1003(a) prescribes the notice required in rule making proceedings such as that involved here.

> "General notice of proposed rule making shall be published in the Federal Register (unless all persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law) and shall include (1) a statement of the time, place, and nature of public rule making proceedings; (2) reference to the authority under which the rule is proposed; and (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved."

The essential element of adequate notice is that it "fairly apprise interested persons of the issues involved, so that they may present relevant data or argument." H. Rept. No. 1980, 79th Cong., 2d Sess. 24; see also S. Rept. No. 752, 79th Cong., 1st Sess. 14. We submit the Commission's Notice of Proposed Rule Making met this standard.

In its Notice, the Commission adverted specifically to the long standing prohibition of hobbying in the Citizens Band Service. 27 F.R. 11500. It was also noted that the proposed amendments were designed to make more apparent the permissible and prohibited uses.

Clearly this notice was sufficient in that it contained "the substance of the proposed rule or a description of the subject and issues involved." Petitioner had ample opportunity to bring to the attention of the Commission whatever evidence or views it thought relevant to the issues. The provisions of changed 95.1 were actually adopted in lieu of more detailed limitations on permissible communications originally proposed as Section 19.61 (95.81) in the Notice of Proposed Rule Making. In addition, the change was entirely consistent with other proposals contained in the Notice. For the same reason petitioner's claim that other provisions were adopted without adequate notice is without merit.

We do not read the Administrative Procedure Act to require an agency to publish in advance every precise proposal which may be ultimately adopted. Pacific Coast European Conference v. United States, 350 F.2d 197 (9th Cir. 1965); Willapoint Oysters, Inc. v. Ewing, 174 F.2d 676, 684 (9 Cir. 1949), cert. denied 338 U.S. 860 (1949). See also, Wilson and Co. v. United States, 335 F.2d 788 (7th Cir.1964), cert. denied 380 U.S. 950; Owensboro On The Air, Inc. v. United States, 262 F.2d 702 (D.C. Cir., 1958); Logansport Broadcasting Corp. v. United States, 210 F.2d 24 (D.C. Cir., 1954). As the Court of Appeals states in Logansport:

> "Surely every time the Commission decided to take account of some additional factor it was not required to start the proceeding all over again.

> If such were the rule, the proceedings might never be terminated." 210 F.2d at 28.

And this Court has said, in Pacific Coast, supra:

> "Since the Commission was proceeding in the area where rule making was not required to be made 'on the record,' the notice and hearing requirements of Section 4(b) of the Administrative Procedure Act were met if the Conference had notice and an opportunity to present its views to the Commission." 350 F.2d 197, 206.

In sum, there is no substantial doubt as to the adequacy of notice under the Administrative Procedure Act.

C) The Record Is Adequate To Support The Commission's Action.

Petitioner further argues (Br., pp. 21-25) that additional material should have been made a part of the record,[15] and that without it the Court cannot determine whether the Commission's decision is supported by substantial evidence. Petitioner points to several instances wherein the Commission referred, either in its Notice of Proposed Rule Making or in the Report and Order adopting the rules to "operational experience over the years" and to "monitoring, inspections and investigations" conducted by Commission personnel.[16]

[15] Petitioner has previously moved this Court for an order to include in the record certain materials. The Commission filed an Opposition, and the Court entered an Order on December 21, 1965, denying the motion without prejudice to a further consideration of the question when the cause is heard on the merits.

[16] The increased evidence of overcrowding and disregard for the rules in the Citizens Service has long been a matter of public record. See, e.g., Federal Communications Commission Annual Report, pp. 84-85 (1960); Federal Communications Commission Annual Report, p. 83 (1961); Federal Communications Commission Annual Report, p. 101 (1963); Federal Communications Commission Annual Report, pp. 90, 98, (1964).

It argues that this data should have been included in the record so that it could be subject to rebuttal and examined by a reviewing court.

At the outset we point out that no request for this data was ever made to the Commission. The matter is therefore not properly before the Court and may not be considered. 47 U.S.C. 405; Federal Power Commission v. Colorado Interstate Gas Co., 348 U.S. 492 (1955); United States v. Tucker Truck Lines, 344 U.S. 33, 36-37 (1952); Unemployment Compensation Commission of Alaska v. Oregon, 329 U.S. 143, 155 (1946); Florida Gulf Coast Broadcasters, Inc. v. Federal Communications Commission, 352 F.2d 726 (D.C. Cir. 1965).

The allegation is, in any event, wholly without merit. There is no requirement that the proceeding conducted by the Commission be "on the record," and accordingly sections 7 and 8 of the Administrative Procedure Act, 5 U.S.C. 1006, 1007 and the case law upon which petitioner relies are totally inapposite.[17/] The Commission's action was rule making in the broadest sense. Since this is essentially a legislative process, the agency need not proceed on evidence formally presented at hearings, and could properly "act on the basis of data contained in its own files, on

17/ Thus, Wirtz v. Baldor Electric Co., 337 F.2d 518 (D.C. Cir., 1964) upon which petitioner principally relies, is not in point. Section 10(b) of the Walsh-Healey Act, 66 Stat. 308, 41 U.S.C. Sec. 43(a), on which the court relied, requires the Secretary's determinations to be made "on the record after opportunity for a hearing." 337 F.2d at 521.

information informally gained by members of the body, on its own expertise, or on its own views or opinions. It is not necessary for the regulatory agency to cause to be submitted at hearings evidence that would support its rulemaking decisions." Flying Tiger Line, Inc. v. Boyd, 244 F. Supp. 889, 892, (D.D.C., 1965), affirmed sub nom. Flying Tiger Line, Inc. v. Murphy, Case No. 19,869, D.C. Cir., decided by Judgment Order issued June 2, 1966. Pacific Coast European Conference v. United States, supra at 205. Indeed in the notice of proposed rule making herein the Commission expressly stated that it proposed to take into account "other relevant information before it, in addition to specific comments invited by this notice." (R. Vol. I-A, p. 5, 27 Fed. Reg. 11501).

Section 4(b) of the Administrative Procedure Act, 5 U.S.C. 1003(b) states, in part: " . . . after consideration of all relevant matters presented, the agency shall incorporate in any rules adopted a concise general statement of their basis and purpose." All that is necessary is that the Commission comply with this requirement. Manifestly, it has done so here. As this Court has stated:

> In determining the propriety of rules of general application only a legal question is presented - whether on the factual premise upon which the Commission acted the rule promulgated is unreasonable, arbitrary, capricious or discriminatory. If the factual premise itself were open to review, then it would be necessary for all general rule-making to include a trial-like hearing. Superior Oil Co. v. Federal Communications Commission, supra at 619. Accord, Willapoint Oysters v. Ewing, supra; Van Curler Broadcasting Corp. v. United States, 236 F.2d 727, 730 (D.C. Cir., 1956).

By its request for additional "evidence," petitioner is simply seeking to litigate the factual premise on which the Commission acted. This it may not do.

CONCLUSION

For the foregoing reasons the orders here under review should be affirmed.

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September 15, 1966

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

WILLIAM L. FISHMAN,
Counsel.

APPENDIX A

Section 4 of the Administrative Procedure Act, 5 U.S.C. 1003.

Section 4. Except to the extent that there is involved (1) any military, naval, or foreign affairs function of the United States or (2) any matter relating to agency management or personnel or to public property, loans, grants, benefits, or contracts--

(a) NOTICE.--General notice of proposed rule making shall be published in the Federal Register (unless all persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law) and shall include (1) a statement of the time, place, and nature of public rule making proceedings; (2) reference to the authority under which the rule is proposed; and (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved. Except where notice or hearing is required by statute, this subsection shall not apply to interpretative rules, general statements of policy, rules of agency organization, procedure, or practice, or in any situation in which the agency for good cause finds (and incorporates the finding and a brief statement of the reasons therefor in rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.

(b) PROCEDURES.--After notice required by this section, the agency shall afford interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity to present the same orally in any manner; and, after consideration of all relevant matter presented, the agency shall incorporate in any rules adopted a concise general statement of their basis and purpose. Where rules are required by statute to be made on the record after opportunity for an agency hearing, the requirements of sections 7 and 8 shall apply in place of the provisions of this subsection.

[Sections (c) and (d) omitted]

Sections 303 (a), (b), (f) and (g), 316, 326 and 405 of the Communications Act of 1934, as amended, 47 U.S.C. 303 (a), (b), (f) and (g), 316, 326 and 405.

Section 303. Except as otherwise provided in this Act, the Commission from time to time, as public convenience, interest, or necessity requires shall--

(a) Classify radio stations;

(b) Prescribe the nature of the service to be rendered by each class of licensed stations and each station within any class;

* * *

(f) Make such regulations not inconsistent with law as it may deem necessary to prevent interference between stations and to carry out the provisions of this Act: Provided, however, that changes in the frequencies, authorized power, or in the times of operation of any station, shall not be made without the consent of the station licensee unless, after a public hearing, the Commission shall determine that such changes will promote public convenience or interest or will serve public necessity, or the provisions of this Act will be more fully complied with;

(g) Study new uses for radio, provide for experimental uses of frequencies, and generally encourage the larger and more effective use of radio in the public interest;

Section 316. (a) Any station license or construction permit may be modified by the Commission either for a limited time or for the duration of the term thereof, if in the judgment of the Commission such action will promote the public interest, convenience, and necessity, or the provisions of this Act or of any treaty ratified by the United States will be more fully complied with. No such order of modification shall become final until the holder of the license or permit shall have been notified in writing of the proposed action and the grounds and reasons therefor, and shall have been given reasonable opportunity, in no event less than thirty days, to show cause by public hearing, if requested, why such order of modification should not issue: Provided, That where safety of life or property is involved, the Commission may by order provide for a shorter period of notice.

(b) In any case where a hearing is conducted pursuant to the provisions of this section, both the burden of proceeding with the introduction of evidence and the burden of proof shall be upon the Commission. [Footnote omitted]

Section 326. Nothing in this Act shall be understood or construed to give the Commission the power of censorship over the radio communications or signals transmitted by any radio station, and no regulation or condition shall be promulgated or fixed by the Commission which shall interfere with the right of free speech by means of radio communication. [Footnote omitted]

Section 405. After an order, decision, report, or action has been made or taken in any proceeding by the Commission, or by any designated authority within the Commission pursuant to a delegation under section 5(d)(1), any party thereto, or any other person aggrieved or whose interests are adversely affected thereby, may petition for rehearing only to the authority making or taking the order, decision, report, or action; and it shall be lawful for such authority, whether it be the Commission or other authority designated under section 5(d)(1), in its discretion, to grant such a rehearing if sufficient reason therefor be made to appear. A petition for rehearing must be filed within thirty days from the date upon which public notice is given of the order, decision, report, or action complained of. No such application shall excuse any person from complying with or obeying any order, decision, report, or action of the Commission, or operate in any manner to stay or postpone the enforcement thereof, without the special order of the Commission. The filing of a petition for rehearing shall not be a condition precedent to judicial review of any such order, decision, report, or action, except where the party seeking such review (1) was not a party to the proceedings resulting in such order, decision, report, or action, or (2) relies on questions of fact or law upon which the Commission, or designated authority within the Commission, has been afforded no opportunity to pass. The Commission, or designated authority within the Commission, shall enter an order, with a concise statement of the reasons therefor, denying a petition for rehearing or granting such petition, in whole or in part, and ordering such further proceedings as may be appropriate: Provided, That in any case where such petition relates to an instrument of authorization granted without a hearing, the Commission, or designated authority within the Commission, shall take such action within ninety days of the filing of such petition. Rehearings shall be governed by such general rules as the Commission may establish, except that no evidence other than newly discovered evidence, evidence which has become available only since the original taking of evidence, or evidence which the Commission or designated authority within the Commission believes should have been taken in the original proceeding shall be taken on any rehearing. The time within which a petition for review must be filed in a proceeding to which section 402(a) applies, or within which an appeal must be taken under section 402 (b) in any case, shall be computed from the date upon which public notice is given of orders disposing of all petitions for rehearing filed with the Commission in such proceeding or case, but any order, decision, report or action made or taken after such rehearing reversing, changing, or modifying the original order shall be subject to the same provisions with respect to rehearing as an original order. [Footnote omitted]

Section 95.83 of the Commission's Rules and Regulations, 47 CFR §95.83.

Subpart D--Station Operating Requirements

SOURCE: The provisions of this Subpart D appear at 29 F.R. 11108, July 31, 1964, except as otherwise noted.

§95.83 Prohibited uses.

(a) A Citizens radio station shall not be used:

(1) For engaging in radio communications as a hobby or diversion, i.e., operating the radio station as an activity in and of itself.

[Note omitted]

(2) For any purpose, or in connection with any activity, which is contrary to Federal, State, or local law.

(3) For the transmission of communications containing obscene, indecent, or profane words, language, or meaning.

(4) To carry communications for hire, whether the remuneration or benefit received is direct or indirect.

(5) To communicate with stations authorized or operated under the provisions of other parts of this chapter, with unlicensed stations, or with United States government or foreign stations, except for communications pursuant to §§95.85(b) and 95.121.

(6) For any communication not directed to specific stations or persons, except for: (i) Emergency and civil defense communications as provided in §§95.85(b) and 95.121, respectively, (ii) test transmissions pursuant to §95.93, and (iii) communications from a mobile unit to other units or stations for the sole purpose of requesting routing directions, assistance to disabled vehicles or vessels, information concerning the availability of food or lodging, or any other assistance necessary to a licensee in transit.

(7) To convey program material for retransmission, live or delayed, on a broadcast facility.

[Note omitted]

(8) To interfere maliciously with the communications of another station.

(9) For the direct transmission of any material to the public through public address system or similar means.

(10) To transmit superfluous communications, i.e., any transmissions which are not necessary to communications which are permissible.

(11) For the transmission of music, whistling, sound effects, or any material for amusement or entertainment purposes, or solely to attract attention.

(12) To transmit the word "MAYDAY" or other international distress signals, except when a ship, aircraft, or other vehicle is threatened by grave and imminent danger and requests immediate assistance.

(13) For transmitting communications to stations of other licensees which relate to the technical performance, capabilities, or testing of any transmitter or other radio equipment, including transmissions concerning the signal strength or frequency stability of a transmitter, except as necessary to establish or maintain the specific communication.

(14) For relaying messages or transmitting communications for a person other than the licensee or members of his immediate family, except: (i) Communications transmitted pursuant to §§95.85(b), 95.87(b)(7), and 95.121; and, (ii) upon specific prior Commission approval, communications between citizens radio stations at fixed locations where public telephone service is not provided.

(15) For advertising or soliciting the sale of any goods or services.

(16) For transmitting messages in other than plain language. Abbreviations, including nationally or internationally recognized operating signals, may be used only if a list of all such abbreviations and their meaning is kept in the station records and made available to any Commission representative on demand.

(b) A Class D station may not be used to communicate with, or attempt to communicate with, any unit of the same or another station over a distance of more than 150 miles.

(c) A licensee of a Citizens radio station who is engaged in the business of selling Citizens radio transmitting equipment shall not allow a customer to operate under his station license. In addition, all communications by the licensee for the purpose of demonstrating such equipment shall consist only of brief messages addressed to other units of the same station.

[29 F.R. 11108, July 31, 1964, as amended at 30 F.R. 2712, Mar. 3, 1965]

No. 20030

United States Court of Appeals

FOR THE NINTH CIRCUIT

CALIFORNIA CITIZENS BAND ASSOCIATION, INCORPORATED, a Corporation,
Petitioner.

vs.

THE UNITED STATES OF AMERICA and FEDERAL COMMUNICATIONS COMMISSION,
Respondents.

PETITIONER'S CLOSING BRIEF

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PETITIONER'S CLOSING BRIEF

I.

COUNTER STATEMENT OF FACTS

Respondent Federal Communications Commission in its reply brief has alleged that petitioner's statement of the case is misleading and incomplete but nowhere does it specifically spell out such inaccuracies. The record, as shown by the Federal Register from the date of November 21, 1946 *(11 FR 13704)* until 1960 is quite clear that "The possible uses of this service are as broad as the imagination of the public and the ingenuity of equipment manufacturers can devise." No specific prohibition on social, hobbying, personal or business use was originally contained in Part 19. It was an "all purpose band." Further, the Commission intended to keep to a miuimum its rules

and regulations governing the service. See *11 FR 13705.*

For many years the Commission has been stating that there are no more channels available for the Citizens Band. It is interesting to note that the courts have gone along with the aforesaid declaration. The court rulings have been based entirely upon unchallenged Commission expertise. No one has been allowed to introduce evidence in rebuttal to the Commission's position, or if so, no particular weight has been attached thereto. Petitioner states in rebuttal that the radio spectrum is boundless. It extends from zero cycles per infinity to quantum mechanical-spectrural presentations of numerical cycles per unit of relative time, the bounds of which are unknown, due to lack of knowledge. However in 1965 the Commission stated in its annual report on page 172 as follows:

> "Improvements have been made in the channel occupancy recorders for VHF and UHF. Further laboratory observations verify the great imbalance in channel loading between different licensed services, and the existence of numerous vacant channels."

Attention is called to page 143 of the 1965 annual report of the respondent FCC. There the following statement is made:

> "About three-quarters of a million licenses now use this low-power, short-distance radio service to meet their varied radio communication needs

> on land, sea and in the air. They constitute the largest single group of station licenses. Although applications for citizens radio station licenses continued to be filed in large numbers, the total submitted in fiscal 1965 was about 20% less than in the previous year . . . Final action on a major revision of the rules governing this radio service was taken (docket 14843) in fiscal 1965. These new rules, designed to emphasize and strengthen long-standing limitations upon permissible communications, became effective April 26, 1965. Initial enforcement efforts indicate that responsible licensees are adhering to the new rule provisions. Nevertheless, numerous violations are still occurring and a stepped-up program of education and enforcement is underway to help preserve the usefullness of the service."

Obviously, from the foregoing, the rules the respondent Commission adopted in 1965, and which are the subject of this controversy, have caused the general public to lose interest in obtaining a CB license to some extent and have failed in their purpose in decreasing violations of the rules. From the foregoing, the only conclusion to be reached is that the foregoing rules have been a complete failure and should not be continued.

II.

QUESTIONS PRESENTED

Respondent Commission states on page 13a of its Brief that it considers that only two questions are

presented. These are in connection with freedom of speechc and any possible violation of procedural rights under the Communications Act or Administrative Procedure Act. The specifications of error outlined by appellants are mainly ignored.

In respondent's Summary of Argument on page 14 it states that petitioner has failed to show that the limitations imposed by the Commission's rules are in any way unreasonable or contrary to the public interest standard of the Communications Act. In support of its action respondent has cited *Lafayette Radio Electronics Corp.* v. *U.S.*, 345 F 2d 278 (2nd Cir. 1965). The foregoing action was filed on Friday, April 23, 1965 and heard on Monday, April 26, 1965. The reviewing court did not have the record before it as it would have been physically impossible to have prepared the same between Friday and Monday. The petitioner therein was a manufacturer and seller of electronic equipment as well as a licensee, and the decision therein was apparently based at least in part on the question of hobbying. Petitioner herein is not urging this court to permit hobbying, but has raised many basic and fundamental issues which were not presented in *Lafayette*, supra.

Respondent relies heavily for its authority on *National Broadcasting Co.* v. *U.S.*, 319 U.S. 190 (1943). It states on page 29 of its Brief that adjudicatory hearings were not held. However, on page 195 of the aforesaid decision the court states that public

hearings were held for seventy-three days, notice was sent to the station licensees involved, all were invited to appear and finally that briefs were submitted.

Respondent cites as its authority for rule making without hearing even though a license may be affected (page 15 of respondent's brief) *Federal Power Commission* v. *Texaco*, 377 U.S. 33; *American Airlines* v. *Civil Aeronautics Board*, 359 F 2nd 624; *Superior Oil Co.* v. *Federal Power Commission*, 322 F 2nd 601; *Willapoint Oysters* v. *Ewing*, 174 F 2nd 676. Petitioner wishes to point out that the aforesaid are readily distinguishable from the case at bar in that they all involved applications (except Willapoint) for either new licenses or permission to engage in certain activities. They had acquired no rights which were about to be curtailed or taken away, but were seekers of new rights or privileges. No existing licenses were being modified.

1. Necessity for Publication

Respondent states on page 16 of its brief that it "is not required to publish in advance every precise proposal which may ultimately be adopted." *Willapoint*, supra and *Wilson and Co.* v. *U.S.*, 335 F 2nd

788 are cited as authority. *Willapoint* stated that it was sufficient to let the petitioner know what issues it would face at a hearing to be held. *Wilson*, supra, concerned telegraph rates, and it was held that the notice was as specifiic as the commission could make it

read. However, neither case involved the imposition of criminal penalties for violation of the regulations as does the case herein. As pointed out in petitioner's opening brief on page 36 thereof, violations of the directives of Commission Rule 95.83 are now criminal and subject to punishment under 47 USC 501 and 502. Rules with criminal penalties for violation thereof should be published to afford certainty. *Hotch* v. *United States*, 212 F 2nd 280 is a case in point. Hotch was convicted of fishing in violation of a regulation of the Department of the Interior extending the period closed to commercial fishing on the Taku Inlet in Alaskan waters. The 9th Circuit Court affirmed holding that the regulation was valid. On petition for rehearing, Hotch raised for the first time that the regulation was not effective in that it had not been published in the Federal Register. The Court reversed the conviction, holding that actual knowledge would not be sufficient. The case states on page 282:

> "The Congressional directive in regard to the procedure to be followed in the issuance of agency regulations must be strictly complied with, since the issuance of regulations is in effect an exercise of delegated legislative power. In the case before us, neither notice that a regulation extending the closed period on the Taku inlet was to be issued, nor the proposed regulation itself was published in the Federal Register. The failure to comply with either of the referred to provisions of the Administrative Procedure Act means that the procedure laid

> down by Congress for the implimentation of agency rules has not been met."

It would seem from the *Hotch* case, supra, that in order to render a criminal statute effective the agency must strictly follow the provisions of 5 USC 1002 a (3) which states:

> "Every agency shall separately state and currently publish in the Federal Register . . . (3) substantive rules adopted as authorized by law."

2. Necessity for Hearing

Petitioner has pointed out in its opening brief that 47 USC 316 (a) provides that no hearing is required on a modification of a license unless one is requested. (See page 26 thereof). Respondent states on page 26 in its brief "That because of the very large number of licensees in the service it would be impracticable, if not impossible to obtain individual consent to the rules or to afford separate hearings." Such argument is fallacious in that 316a does not require the Commission to obtain individual consent and to afford separate hearings. A hearing is only granted upon request. The record herein will disclose that probably not more than six or eight participants requested a hearing. Petitioner herein was one of those who did. Respondent in the matter herein, should have held a hearing in a convenient place and invited those who requested the same to attend.

Respondent has cited as authority *Airline Pilots Association International* v. *Quesada*, 276 F. 2nd 892. Therein the FAA had issued a regulation without a hearing that all airline pilots over the age of sixty would no longer be issued a certificate which would enable them to fly in such occupation. This case can be distinguished from the matter herein that public safety required urgent, immediate action. Taking the extended time necessary for the holding of hearings would not be in the public interest in that air crashes might result in the interim.

III.

CONCLUSION

For the reasons as outlined in its opening and closing briefs, petitioner submits that the rules of respondent Commission which were effective April 26, 1965 should be set aside and the case remanded to the said Commission for hearing and further proceedings.

Dated: October 6, 1966, Oakland, California.

Respectfully submitted,

SEA AND HANNA

Attorneys for Petitioner

I certify that in conjunction with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion the foregoing brief is in full compliance with those rules.

DONALD M. SEA

NO. 20032

IN THE UNITED STATES COURT OF APPEALS

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MAX G. WENDELL,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA
CENTRAL DIVISION

FILED

SEP 22 1966

WM. B. LUCK, CLERK

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APPELLEE'S BRIEF

I

JURISDICTIONAL STATEMENT

On March 4, 1964, a nine-count indictment was returned against appellants and one Robert W. Stanley by the Federal Grand Jury for the Southern District of California, Central Division [C. T. 2-16]. 1/

The indictment charged perjury, subornation of perjury and obstruction of justice in connection with the prior trial of appellant Falk for armed robbery of a savings and loan association, at which he was acquitted by a jury.

Falk was convicted of one count of perjury (Count Two), and

1/ C. T. refers to Clerk's Transcript on Appeal.

one count of obstruction of justice (Count Nine). Wendell was convicted of one count of perjury (Count Six). Attorney Robert W. Stanley was acquitted of all charges [C. T. 47].

Appellants were both sentenced to the custody of the Attorney General for five years with the provision that they be eligible for parole at any time [C. T. 48].

Appellants filed timely notices of appeal, and were granted leave to appeal in forma pauperis [C. T. 57, 61].

The jurisdiction of the District Court was predicated on Title 18, United States Code, Sections 1503, 1621 and 3231. This Court has jurisdiction to entertain this appeal under the provisions of Title 28, United States Code, Sections 1291 and 1294.

II

STATUTES INVOLVED

Title 18, United States Code, Section 1503 provides:

"INFLUENCING OR INJURING OFFICER, JUROR OR WITNESS GENERALLY - Whoever corruptly, or by threats or force, or by any threatening letter or communication, endeavors to influence, intimidate, or impede any witness, in any court of the United States or before any United States Commissioner or other committing magistrate, or any grand or petit juror, or officer in or of any court of the United States, or officer who may be serving at any examination or

other proceeding before any United States commissioner or other committing magistrate, in the discharge of his duty, or injuries any party or witness in his person or property on account of his attending or having attended such court or examination before such officer, commissioner, or other committing magistrate, or on account of his testifying or having testified to any matter pending therein, or injuries any such grand or petit juror in his person or property on account of any verdict or indictment assented to by him, or on account of his being or having been such juror, or injuries any such officer, commissioner, or other committing magistrate in his person or property on account of the performance of his official duties, or corruptly or by threats or force, or by any threatening letter or communication, influences, obstructs, or impede, the due administration of justice, shall be fined not more than $5,000 or imprisoned not more than five years, or both."

Title 18, United States Code, Section 1621 provides:

"PERJURY GENERALLY - Whoever, having taken an oath before a competent tribunal, officer, or person, in any case in which a law of the United States authorizes an oath to be administered, that he will testify, declare, depose, or certify truly, or that

any written testimony, declaration, deposition, or certificate by him subscribed, is true, willfully and contrary to such oath states or subscribes any material matter which he does not believe to be true, is guilty of perjury, and shall, except as otherwise expressly provided by law, be fined not more than $2,000 or imprisoned not more than five years, or both."

III

STATEMENT OF THE CASE

Appellants were indicted along with an attorney, Robert W. Stanley, on March 4, 1964, on charges of perjury, subornation of perjury and obstruction of justice, arising out of the former trial of appellant Falk for bank robbery [C. T. 2]. Stanley was Falk's attorney at the bank robbery trial in which Falk was found not guilty by a jury.

Appellants were arraigned on March 16, 1964, and entered pleas of not guilty on May 4, 1964 [C. T. 17, 24].

The trial of appellants and Stanley commenced on July 8, 1964, before the Honorable C. Nils Tavares, United States District Judge, sitting without a jury, following the filing of written waiver of a trial by jury [C. T. 38].

On July 21, 1964, the Court dismissed Counts One, Three, Four and Six against Falk on the ground of Res Judicata, found him guilty as to Counts Two and Nine, and not guilty as to Counts

Five, Seven and Eight. On the same day, the Court found Wendell guilty as to Count Six, not guilty as to Count Seven, and found Stanley not guilty on all counts in which he was charged [C. T. 47].

Count Two of the indictment, of which Falk was convicted, charged that in the bank robbery trial the following testimony of Falk was knowingly false:

"Q. Mr. Falk, when you escaped from the Chino institution, you were not alone, were you?

"A. Oh, yes, I escaped alone.

"Q. You were joined shortly thereafter in that case by a fellow escapee Christopher Zaccaria, were you not?

"A. I met the fellow in Los Angeles.

"Q. He was an escapee from Chino?

"A. He was but he did not escape with me." [C. T. 6].

Count Six of the indictment charged Wendell with knowingly giving the following false testimony at the prior trial:

"Q. Now, at some time during the month of August [1963] did Gene Patterson bring an automobile over to your house?

"A. Yes, sir, it was '50 Plymouth, two-door sedan; a blue one.

* * *

"Q. Then did he ever pick the car up?

"A. Yes, sir, he come over one morning on -- around 10:00, 10:30 and said he wanted to use the car for some -- I don't know. The way he told me it was some bank job. I told him, I said, 'Don't plan on me going with you. I don't want to.' He said, 'No, I got a friend here with me. We will take the car and take it away.'

"Q. He said that to you where, in the house?

"A. I was standing in the doorway of my house.

"Q. Did you see the person who was with him?

"A. Yes, sir.

* * *

"Q. Were you at that time acquainted with a Chet Helpman?

"A. Chet was the one that was with him that day. * * *

"Q. Where was he? Was he in the car?

"A. He was in Gene's car.

"Q. And did they take the car?

"A. Gene drove the car away, yes sir.

* * *

"Q. Mr. Patterson drove which car away?

"A. The '50 Plymouth.

"Q. What car did they come in?

"A. They came in, oh, about a '55 Chrysler, blue and white Chrysler"

Count Nine, the other count of which Falk was convicted charged Falk and Stanley with endeavoring to obstruct and impede the administration of justice by endeavoring to influence the testimony of two prospective witnesses, Clara Belle Miller and Ronald Lee Miller, in the prior bank robbery trial.

Falk was sentenced to five years imprisonment under Title 18, United States Code, Section 4208(a), on each of Counts Two and Nine, to run concurrently. Wendell was sentenced to imprisonment for a term of five years under Title 18, United States Code, Section 4208(a), on Count Six.

IV

STATEMENT OF FACTS

A. The Trial of Appellant Falk For Armed Bank Robbery

1. Government's Proof

On August 20, 1966, an armed robbery was committed by two men at the Avalon Savings and Loan Association in Wilmington, California. Gene L. Patterson and Appellant Falk were indicted for the robbery.

Patterson pleaded guilty and testified as a Government

witness at the trial of Falk [T. R. 183]. 2/

Patterson testified that he met Falk on August 20, 1963, because Falk wanted to borrow some guns for a robbery. Patterson and Falk decided to go out together and look for something to rob. They then went out and drove around, and Falk showed Patterson the Avalon Savings and Loan Association which was a place he, Falk, had cased before going to jail [T. R. 187-189].

They then went and picked up an old Plymouth automobile. Thereafter, Falk suggested that he put makeup on Patterson to simulate a scar, because the person with whom Falk had recently escaped from State Prison had such a scar. Patterson testified they then went and robbed the Association [T. R. 190-192].

Six employees of the Association identified Falk as one of the two men who robbed the bank, and one of them testified that he had leaned on the counter [T. R. 22, 52, 53, 83, 126, 144 and 159]. Falk's palm print was found at that spot [T. R. 280, 285, 291]. The janitorial service testified that the counter was cleaned every night [T. R. 408].

2. Falk's Defense

Falk testified that he did not commit the robbery, although he had gone to the Association the previous day with Patterson and others to "case" it [T. R. 333-334]. However, he decided not

2/ T. R. refers to transcript of the robbery trial which was an exhibit in this case.

to rob it [T. R. 348]. He further testified that he did not escape from State Prison with someone else but rather alone [T. R. 348].

Appellant Wendell then testified that Patterson came by his house to pick up a car in August with Chet Helpman, and told Wendell that he, Patterson, and Helpman were going to rob a bank [T. R. 394-400].

Chet Helpman was called to the stand by the defense and claimed the privilege against self-incrimination on all questions put by the defense in connection with the robbery, although he was later produced as a Government witness and denied his participation [T. R. 305-310, 429].

B. Facts of the Instant Case

1. Count Two - Falk's Escape From Prison

The records of the Department of Correction at Chino, California, showed that at 9:10 P. M., on August 13, 1963. Appellant Falk and Christopher Zaccaria, both inmates at the institution, were present for the count [R. T. 202]. 3/ However, at the 11:00 P. M. count, both were missing [R. T. 101].

After his apprehension, Falk told a Chino Official and Police Officer that he had escaped with another person whose name was

3/ R. T. refers to Reporter's Transcript.

Zaccaria by going out a bathroom window [R. T. 205]. In addition, Falk admitted that he escaped with another person to Patterson and F. B. I. agents [R. T. 137, 551 and 577].

2. Count Nine - The Efforts By Falk to Influence the Millers to Give Him An Alibi

Within a few days after the robbery, Mr. and Mrs. Miller were introduced to Falk by Patterson [R. T. 315]. On one occasion, the Millers attended the robbery trial and spoke to Falk during a recess. Falk indicated that he wanted to talk to them and a meeting was arranged at the jail that night [R. T. 316].

At this meeting, Falk asked the Millers to testify at the robbery trial that he, Falk, was at their house at the time of the robbery [R. T. 321-322]. Falk had not been at their house at that time [R. T. 355].

Before the robbery trial, Mr. Miller had talked to an F. B. I. agent, and told the agent about persons who had stayed at their house during the summer of 1963, including Falk and Patterson [R. T. 354].

Falk testified that at that meeting he did ask them to be witnesses but to testify about a loan of $50 and some luggage by Mr. Miller to Falk after the robbery [R. T. 910].

There was also evidence that the following night Mrs. Falk, appellant Falk's wife, came by the Miller's house with a subpoena for Mr. Miller [R. T. 346-347].

3. Count Six - Patterson's Visit to Wendell's House With Helpman to Pick Up a Car.

Appellant Wendell testified for the defense at the robbery trial that in August, 1963, Patterson came by his house to pick up an old Plymouth, the battery of which was being charged, with Chet Helpman. He also testified that Patterson said he and Helpman were going out to rob a bank, and then that Patterson drove off in the Plymouth [T. R. 394-400].

Helpman testified at the instant trial that he never went with Patterson to Wendell's house to pick up a car and left in separate cars [R. T. 257]. He further testified that when Falk asked him to claim the Fifth Amendment, Falk stated that he had asked Wendell to testify that Helpman had been to Wendell's house on the robbery, but that Wendell wouldn't so testify without the consent of Helpman [R. T. 229].

Patterson testified that on the day before the robbery, he left an old 1948 Plymouth at Wendell's house and put a battery charge on it. The day of the robbery, he and Falk went over to Wendell's and picked up the Plymouth and that Wendell was there when Falk drove the Plymouth away, and he, Patterson, drove his Chrysler away [R. T. 133-135]. He further testified that Falk and Wendell spoke to each other [R. T. 136].

Edward Bryan Ballard, who was in County Jail with Wendell during the robbery trial, testified that on February 13, 1964, Wendell told him he was going to testify for Falk in Federal Court

to the effect that "Chet", rather than Falk, was in the car with Patterson when they came over to his house. Wendell also told Ballard that Chet was not in the car [R. T. 392]. Wendell said it was already fixed up that Chet wouldn't get into trouble, and that he, Wendell, was going to perjure himself [R. T. 393].

The next day Wendell told Ballard that he had been to court and testified as he had indicated he would [R. T. 394].

V

SPECIFICATION OF ERRORS

A. Appellant Falk Has Alleged the Following Errors:

1. The trial court erred in failing to grant the defendant's motion for judgment of acquittal on the perjury count. The prosecution failed to introduce the quantum of evidence necessary to convict of perjury and further failed to prove that the allegedly perjured statement was "material".

2. The trial court erred in failing to grant the defendant's motion for judgment of acquittal on the obstruction of justice count. The defendant was indicted for endeavoring to influence, intimidate and impede prospective witnesses. The prosecution failed, however, to establish that at the time the act allegedly occurred the individuals involved were witnesses, or prospective witnesses, within the purview of 18 U. S. C. §1503.

3. The trial court erred in introducing admissions of

the defendant that he had escaped from prison together with another inmate. These admissions were made to federal law enforcement officers during interrogation. The evidence shows that at some time the defendant had requested counsel and his requests were ignored. Since it does not appear from the record whether these statements were made before or after the defendant requested counsel, the case should be remanded for testimony on this point. The admissions were introduced at pages 548-52 and 575-77 of the Reporter's Transcript. The testimony with regard to whether the defendant was afforded counsel appears at pages 570-71, 927, 936-37 and 985-87.

B. Appellant Wendell Has Alleged the Following Errors:

1. The record does not contain sufficient evidence to support Wendell's conviction of perjury.

2. Wendell's prosecution for perjury was barred by the doctrine of collateral estoppel.

VI

ARGUMENT

A. THE EVIDENCE ON COUNT TWO WAS SUFFICIENT TO AUTHORIZE THE CONVICTION OF APPELLANT FALK FOR PERJURY.

Appellant Falk contends that there was insufficient evidence produced at trial to convict him of perjury. The evidence in this respect showed that prior to the robbery trial Falk stated to numerous persons that he had escaped from prison with another person named Zaccaria. These statements were corroborated by the fact that both appellant and Zaccaria were discovered missing at the same time and that both were in the prison about an hour and one-half before that.

Appellant Falk relies on Umbriaco v. United States, 258 F.2d 625 (9th Cir. 1958) to support his contention that such evidence is not sufficient to sustain a perjury conviction. In Umbriaco, supra, the defendant had previously testified that she was not a prostitute, but that she had received money for relations with one man. At the perjury trial one man only, Campbell, testified that on several occasions he had paid the defendant for acts of sexual intercourse. The Court pointed out that Campbell's testimony didn't even contradict the defendant's testimony, and reversed stating that a corroborated unsworn admission is not enough. Judge Pope, in his concurring opinion, points out that no case so holds. He points out that the girl's admission did not contradict the

presumably false testimony for even though she denied being a prostitute, she testified that she engaged in acts of prostitution. There the statement simply was not false.

In the case of United States v. Goldberg, 290 F. 2d 729 (2nd Cir. 1961), cert. den. 368 U. S. 899, the Court stated that a corroborated admission is sufficient, although it did not find it necessary to so hold as the Court found that there was other evidence. The Court did go into the history of the sufficiency rule in perjury cases and later discussed the decision upon which appellant Falk here relies.

> "The historical origins of the rule that a conviction for perjury may not be had on the basis merely of 'oath against oath' (citations) are illuminatingly described in 7 Wigmore, Evidence (3d ed. 1940), pp. 273-275. In our time the rule rests on society's obligation to protect a witness 'from oppression, or annoyance, by charges of having borne testimony, ' from those 'against whom his evidence tells,' (citation). Logically that policy would be satisfied by requiring added proof only when the 'oath' relied on by the prosecutor is that of a person in an adversary relation to the defendant. However, the rule clearly goes further; it is most accurately stated in the negative fashion that Wigmore employs, one witness, without corroborating circumstances, does not suffice, p. 273. It differs from the special rule in treason trials in that two witnesses are

not required; indeed, a conviction may sometimes be had when there are none at all, (citations), save as to the identity of physical objects having circumstantial relevancy.

"The special status of evidence of an admission in prosecutions for perjury rests upon the nature of the offense. The relevancy of a defendant's prior or subsequent statement of fact contrary to his testimonial assertion is that, in the absence of evidence of a change in defendant's knowledge, the jury may permissibly infer that one or the other utterance did not reflect defendant's belief at the time it was made. The difficulty is that, without more, there is no more reason for thinking the admission to have been true and the testimony false than the reverse. This reason underlies the holdings that a perjury conviction may not be had solely on the basis of oral admissions contrary to the allegedly perjurious statement, even if several witnesses testify to the admissions. (citations).

"With respect to Count II, appellant relies on the statement in Umbriaco v. United States, 9 Cir. 1958, 258 F.2d 625, 628 that 'a corroborated, oral, unsworn admission of falsity: is never sufficient to support a conviction for perjury, no matter how strong the circumstantial corroboration may be.' Although we have no difficulty with the result there reached,

for reasons pointed out in the concurring opinion of Judge Pope, we think the rule is not so rigid as the majority asserts. Any such view seems quite inconsistent with the Supreme Court's decision in United States v. Wood, supra, that there may be conviction for perjury without the testimony of any 'witness' at all when the circumstantial evidence is sufficiently probative." 290 F.2d 729, 733-735.

B. THE TESTIMONY OF FALK WAS MATERIAL AS TENDING TO IMPEACH THE TESTIMONY OF PATTERSON.

Patterson on direct testimony at the robbery trial stated that he put makeup on his face to give the appearance of a scar at the suggestion of Falk, because Falk had escaped from prison with a man who had such a scar, and that if Falk were identified, the authorities would think that it was Falk's co-escapee rather than Patterson who was involved.

Had Falk testified that he had escaped with such a man, this would have strongly corroborated Patterson, whom the jury had to disbelieve in order to acquit Falk of the robbery. His denial of the escape with Zaccaria contradicted and therefore impeached the testimony of Patterson.

That such testimony is material is clearly established by United States v. Letchor, 316 F.2d 481 (7th Cir. 1963), cert. den.

375 U.S. 824, wherein the Court stated at 316 F.2d 484:

> "Impeachment of a witness goes to his credibility and questions on cross-examination for this purpose may be material in the sense required for a perjury conviction. (citation)."

C. APPELLANT FALK WAS PROPERLY CHARGED WITH AND CONVICTED OF OBSTRUCTION OF JUSTICE.

Count nine of the indictment charged Falk with endeavoring to obstruct and impede the administration of justice by endeavoring to influence the testimony of two prospective witnesses. The charge is not influencing two prospective witnesses, as Falk contends, but rather endeavoring to obstruct and impede the administration of justice in a certain manner, namely, influencing the testimony of the Millers. As such, Falk was fully and fairly informed of what he had to meet at trial.

This case is directly governed by Roberts v. United States, 239 F.2d 467 (9th Cir. 1956). There a party to a civil contract action asked someone to testify that she had seen a written contract. Roberts urged the government failed to prove the crime charged and the court gave its answer:

> "It is also argued that the third count of the indictment is faulty in that it charged appellant with acts constituting obstruction of justice, whereas the evidence discloses no more than an attempt to suborn

perjury; and therefore the rule that a conviction of an attempt to suborn perjury requires either two witnesses or one witness and corroborating circumstances is applicable. Also, that Mrs. Dutcher was not a 'witness' within the meaning of 18 U.S.C.A. § 1503, as she had not been subpoenaed or subjected to any other process of the District Court at the time of the alleged illegal influence.

"Any corrupt endeavor to influence any party or witness, whether successful or not, constitutes obstruction of justice prohibited by said section. See Catrino v. United States, 9 Cir., 1949, 176 F.2d 884. The obstruction of justice statute is broad enough to cover the attempted corruption of a prospective witness in a civil action in a Federal District Court. Here the evidence discloses that appellant corruptly endeavored to influence, obstruct and impede the due administration of justice in his attempt to induce Mrs. Dutcher to give false testimony at the trial. Wilder v. United States, 4 Cir., 1906, 143 F. 433."

The record in this case reflects that Mr. Miller had been interviewed before the robbery trial; that Falk was seeking to use them as an alibi; that their true testimony could have disproved the alibi; and that on February 13, 1964, Mr. Stanley prepared a subpoena for Ronald Miller [R. T. 706, Exhibit H]. As such, it is

clear that Falk was treating them as prospective witnesses, just as the defendant did in the Robert's case, supra.

There is nothing in the statutes or the cases, other than Walker v. United States, 93 F. 2d 792 (8th Cir. 1938), cited by Falk, that indicates that the statute is not designed to cover attempts to secure false testimony from the defendant's witnesses. The Walker case, supra, gives too narrow a construction to the statute and is contrary to the law in this circuit as stated in Roberts, supra.

D. NO ERROR WAS COMMITTED IN ADMITTING THE STATEMENTS OF FALK.

Appellant Falk, for the first time on appeal, challenges the propriety of admitting certain admission to FBI agents. No objection was made at trial which would have given the court an opportunity to inquire into the matter. The court should treat Falk's contention here as it treated a similar one in Robbins v. United States, 345 F. 2d 930 (9th Cir. 1965), wherein the appellant contended for the first time an appeal that he was denied a request for counsel before the Commissioner. There the Court did not consider the question to be properly before the Court.

Even were the Court to consider the question, the evidence in the record from Falk himself indicates that he did not ask to see an attorney until about a week after his arrest [R. T. 936]. The admissions concerning his escape was made on the same day as he was arrested and the following day. The evidence also discloses

that when the agents became aware of his desire to contact an attorney, they went to see him on September 25, 1963 and assisted him in contacting one [R. T. 979]. Falk further admitted to the agents on September 25 that he had been allowed to make calls [R. T. 980].

E. THERE IS SUFFICIENT EVIDENCE IN THE RECORD TO SUPPORT THE CONVICTION OF APPELLANT WENDELL.

The evidence with respect to Count six of the indictment shows that according to Patterson, prior to the robbery, he left an old Plymouth at Wendell's house for a battery charge and went to pick it up with Falk on the day of the robbery [R. T. 133-135].

Helpman testified that he never went with Patterson to Wendell's house to pick up a car and drove away in separate cars [R. T. 257]. He further testified that when Falk asked him to take the Fifth Amendment, Falk told him that Wendell would only testify that it was Helpman at his house with Patterson, if Helpman consented.

Ballard testified that during the trial, Wendell told him that he was going to perjure himself by testifying that it was Chet rather than Falk who came to his house, and afterwards that he had so testified [R. T. 392-394].

The only question raised by Wendell on this question is whether the witnesses were talking about the same day as was Wendell when he testified at the robbery trial.

Wendell's testimony was that in August, 1963, Patterson and Helpman came to his house in Patterson's Chrysler to pick up a Plymouth which Patterson had left for a battery charge; that he saw Helpman in Patterson's Chrysler, and that Patterson drove the old Plymouth away.

Wendell's contention here is that Helpman's testimony does not contradict Wendell's because he said that there was never an occasion when he went to Wendell's house with Patterson to pick up a car and drove away in separate cars.

The testimony of Wendell at the robbery trial shows that Patterson and Helpman must have driven away in separate cars. According to his testimony there, Patterson and Helpman came in one car, a Chrysler, to pick up another, a Plymouth, and that Patterson drove away in the Plymouth. Therefore, it would appear that Helpman would have had to drive away in another car than did Patterson. Moreover, it was Wendell's intention to testify about the same incident and just change the parties. This is corroborated by Falk's statement to Helpman about Wendell's testimony and Wendell's statement to Ballard that he was going to say it was Chet Helpman instead of Falk who came with Patterson. Wendell, in his own testimony, at the instant trial stated that on the occasion about which he was testifying in the robbery trial, the other man drove Patterson's Chrysler away [R. T. 880]. He also testified that his testimony was predicated upon the fact that it wasn't Falk who came to his house but rather Chet Helpman [R. T. 861]. Based upon Wendell's own testimony, there was a direct contradiction between

his testimony at the robbery trial and the testimony of Helpman at the perjury trial. This was amply corroborated by the admissions to Ballard and the testimony of Patterson that it was Falk with whom he, Patterson, went to pick up the old Plymouth.

Goldberg v. United States, supra.

F. APPELLANT WENDELL IS NOT ENTITLED TO THE DEFENSE OF COLLATERAL ESTOPPEL.

Wendell's second point on appeal seeks to extend the res judicata principal to witnesses. He relies for this proposition on the California civil case of Bernhard v. Bank of America, 19 Cal. 2d 807 (1942). While no case has been found which discusses this question in a perjury case, such as is here before the court, it should be noted that the California courts, upon which appellant Wendell relies does not even extend the doctrine of collateral estoppel in perjury cases to protect a defendant who commits perjury.

People v. Housman, 44 Cal. App. 2d 619, 112 P. 2d 944 (1941).

While appellant is quite right that perjury prosecutions of untruthful witnesses consumes the Court's time, it seems a small burden when compared to the necessity that a Court's decision be based upon truthful testimony.

CONCLUSION

For the reasons herein stated the judgment should be affirmed.

Respectfully submitted,

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ROBERT L. BROSIO,
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Attorneys for Appellee,
United States of America.

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Arthur I. Berman

ARTHUR I. BERMAN

Seealso Vols. 3351 3352

No. 20,034

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

BAIZE INTERNATIONAL, INC.,

Appellant,

v.

WILLIAM C. McGINNIS, ET AL,

Respondents.

APPELLANT'S PETITION FOR REHEARING

BARROW, BLAND, REHMET & SINGLETON

FILED
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No. 20,034

In The

United States Court of Appeals

For the Ninth Circuit

Baize International, Inc.,

Appellant,

v.

William C. McGinnis, et al,

Respondents.

APPELLANT'S PETITION FOR REHEARING

On March 11, 1966, this Honorable Court filed its Opinion in this cause affirming the judgment of the trial court. This Petition for Rehearing is being filed pursuant to Rule 23 of the Rules of the United States Court of Appeals for the Ninth Circuit.

As grounds for the Petition for Rehearing, Appellant would show the Court that the case was tried in the Court below on an erroneous theory of the applicable law. The question of the effect of local law and whether it was complied with was entirely omitted from the trial and this is the point which is controlling in this case. The record is silent as to what local law governs the perfection of the assignment, within the meaning of Section 60 of the Bankruptcy Act, and there are no facts disclosing whether or not such local law was complied with.

In the Opinion filed by this Court, in affirming the judgment of the Court below, the Court approved the Appellant's reasoning that the Government Assignment Statute, 41 U.S.C.A. Section 15, did not govern the rights of the parties to an assignment of a claim under a government contract or those rights of third party creditors. The Court agreed with Appellant that the statute only operated to protect the United States. Consequently, it is local law, and not the Federal Statute, which controls whether or not there has been a "perfection" of the assignment, and when, within the meaning of Section 60 of the Bankruptcy Act. The entire trial in the Court below on the issue of whether an act of bankruptcy had occurred and when it became perfected was based on the effect of the Federal Statute, 41 U.S.C.A. 15, and when notice was given to the contracting officer, and the trial in no way touched on the facts of the assignment, what local law controlled or took effect, or when the assignment became perfected under local law.

The entire presentation of the petitioning creditors was the introduction into evidence of assignment of the monies due and to become due pursuant to the contract between the Appellant and the United States Air Force and the date of notice to the contracting officer. The sole theory of these creditors was that, because of the statutory provisions of 41 U.S.C.A. 15, the assignment was void, or was otherwise "unperfected", under the Bankruptcy Act until notice was given to the contracting officer. (Record pages 24-28)

The theory of the Appellant, in the trial court, as expressed in its Memorandum of Points and Authorities, was that once the assignment was made to the Bank of Tokyo in California it became so far perfected that no creditor of Appellant could have acquired any rights superior to the rights of the assignee because the notice and filing require-

ments of 41 U.S.C.A. 15 are for the benefit of the United States. (Record pages 64-68)

The Referee's decision and opinion, which was adopted in full by the District Court, was based solely on the effect of 41 U.S.C.A. 15 on the assignment until notice was given thereunder to the contracting officer. The Referee's opinion states, "But such assignment is in limbo until the statutory requirement of notice to the contracting officer is given." No mention whatsoever is made of State or local law. (Record pages 77-83)

It is, therefore, apparent that the entire consideration of this matter in the Court below was based on an erroneous theory, i.e., that the Federal Statute, 41 U.S.C.A. 15, without regard to State or local law, controlled the question of "perfection" of the assignment for purposes of the four-month period in Section 3 of the Bankruptcy Act. This Court has held just the reverse.

No consideration having been given to this point in the trial court, Appellant respectfully submits that it is inappropriate for this Court to attempt to arrive at a correct decision on the question of "perfection" of the assignment under local law, the record being grossly incomplete on this point.

This Court has decided that, if Japanese law is applicable, the judgment must be affirmed as no notice or consent has been shown in the record as is required under that law. However, the omission of any consideration of whether this is the applicable local law, what its effect is and whether it has been complied with within four months of the filing or not has left the matter open. A hearing on this question would give Appellant the opportunity to show that, in addition to the "consent" to assignment contained in the contract itself, there was oral notice and consent by the contracting officer to the assignment prior to the actual assignment.

The Court has stated that it is entitled to treat the statement in Appellants' initial Brief that the assignment was executed and entered into in Japan as an admission of the Appellant. However, Appellant would point out to the Court that the Appellee took issue with this assertion in his Brief on page 3, and the Appellant, in effect, withdrew this assertion and agreed with Appellee in the Appellant's Reply Brief, page 6, that the record is silent as to where the assignment took place or what local law governed the perfection of the assignment as to third party creditors. The statement of Appellant's Brief that the assignment was *delivered* in Tokyo, Japan, was the result of a misconception on the part of the Appellant's counsel that Mr. J. Asano was an agent of the Bank of Tokyo of California, rather than simply a representative of the Japanese creditors included in the assignment.

The assignment does show that it, or at least copies thereof, came into the possession of the Bank of Tokyo of California at San Francisco, California, on or before July 25, 1961, the date the notice was sent by that Bank from that place to the contracting officer. There is obviously some connection with the State of California, and, as pointed out by the Court in its Opinion, under the present state of the record, it is not certain that it was not actually delivered in California, under the current state of the record.

The record does not show whether or not notice of the assignment or of intention to make the assignment was filed in accordance with Sections 3017, 3018 and 3019.

Under the case of *Costello* v. *Bank of America National Trust & Savings Association* (9th Cir.) 246 F. 2d 807, the above-mentioned statutes are inapplicable to a written contract of this kind, and the general California rule still governs on the question of perfection of the assignment as to third party creditors. It has long been the law in Cali-

fornia that a non-notifying assignee was entitled to priority over *creditors* of the assignor. There has been no presentation of evidence of whether or not the alleged bankrupt and the United States both treated the account as an open book account.

Therefore, Appellant respectfully submits to the Court that, in the light of the Court's ruling that local law controls the question of perfection of the assignment, rather than the Federal Statute, 41 U.S.C.A. 15, the case is one which properly should be remanded to the trial court for a full development of the facts regarding the applicability and effect of the local law upon the perfection of the assignment, and that this Court should grant a rehearing on this matter in order that full briefs and argument can be presented on this point.

Respectfully submitted,

BARROW, BLAND, REHMET & SINGLETON

By
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.....
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I hereby certify that in my judgment the above Petition for Rehearing is well founded and is not interposed for delay.

.....
R. F. Wheless, Jr.

CERTIFICATE OF SERVICE

I hereby certify that, in accordance with Rule 18 of the Rules of the United States Court of Appeals for the Ninth Circuit, I have served upon counsel for the Respondents as named below, three (3) copies each of this Petition for Rehearing by placing the same in the United States Mails with proper postage thereon and addressed as set forth below, on this day of April, 1966.

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R. F. Wheless, Jr.

NO. 20035

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

See also Vol. 3357

UNITED CALIFORNIA BANK, a California corporation,

Appellant,

-vs-

JOHN M. ENGLAND, as Trustee in Bankruptcy of FELDEN INDUSTRIES, INC.,

Appellee.

REPLY BRIEF FOR APPELLANT

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FILED

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NO. 20035

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

UNITED CALIFORNIA BANK,
a California corporation,

Appellant,

-vs-

JOHN M. ENGLAND, as Trustee in Bankruptcy of FELDEN INDUSTRIES, INC.,

Appellee.

On appeal from the United States District Court for the Northern District of California, Southern Division.

REPLY BRIEF FOR APPELLANT

JURISDICTIONAL STATEMENT

The jurisdiction of this Court is set forth in Opening Brief for Appellant and incorporated herein for all purposes.

FACTS OF THIS CASE

The facts of this case have been heretofore set forth in Appellant's Opening Brief.

NO. 20035

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

UNITED CALIFORNIA BANK,
a California corporation,

Appellant,

-vs-

JOHN M. ENGLAND, as Trustee in
Bankruptcy of FELDEN INDUSTRIES,
INC.,

Appellee.

On appeal from the United States District Court
for the Northern District of California,
Southern Division.

REPLY BRIEF FOR APPELLANT

JURISDICTIONAL STATEMENT

The jurisdiction of this Court is set forth in Opening Brief for Appellant and incorporated herein for all purposes.

FACTS OF THIS CASE

The facts of this case have been heretofore set forth in Appellant's Opening Brief.

Appellee has included additional facts in its Reply Brief (pp. 3 & 4) concerning the existence of a creditor, CYCLONE SANDBLAST EQUIPMENT COMPANY, which were not touched upon by Appellant in its Opening Brief. This omission was not designed to mislead the Court in any manner. Prior to the assumption of the liabilities of METAL FAB by the Bankrupt, METAL FAB was indebted to CYCLONE SANDBLAST EQUIPMENT COMPANY. (SUPP. TR 8-10). At the time of the assumption of liabilities of METAL FAB by the Bankrupt and while the chattel mortgage was duly recorded in Alameda County, CYCLONE SANDBLAST EQUIPMENT COMPANY remained a creditor of METAL FAB and became a creditor of the Bankrupt. (SUPP. TR 7, 8, 10, Exhibit I). CYCLONE SANDBLAST EQUIPMENT COMPANY did not have actual knowledge of the existence of the mortgage but had constructive notice of the mortgage by virtue of the recordation of said chattel mortgage, said chattel mortgage having been recorded on August 2, 1963, in the County of Alameda, State of California. CYCLONE SANDBLAST EQUIPMENT COMPANY did not release METAL FAB from its debts and to date remains a creditor of METAL FAB. (TR-10). METAL FAB, Mortgagor, is not a party to the proceedings before this Court.

Appellee has stated as a fact that METAL FAB is, at most, a hollow corporate shell. (Appellee's Reply Brief p.2).

There is nothing in the record to support this gratuitous statement.

Appellee has stated as a fact: "Appellant negligently permitted a secret lien to arise. (TR 8)." Reply Brief of Appellee, (p. 3). This is a conclusion of law made by Appellee and not a statement of fact supported by the record.

ARGUMENT

Appellee has consistently failed to squarely meet the argument of Appellant concerning the construction of CALIFORNIA CIVIL CODE, Section 2957, as to what persons are protected by the provisions thereof. This section is set forth at length in Appellant's Opening Brief on p.5. The classes of persons specified are "creditors of the mortgagor and subsequent purchasers and incumbrancers of the property in good faith and for value."

In this proceeding CYCLONE SANDBLAST EQUIPMENT COMPANY is a creditor of FELDEN who is not the mortgagor and not a creditor of METAL FAB (who is the mortgagor). As a creditor of FELDEN it is a creditor of the assignee of the mortgagor (METAL FAB), and not within the classes protected by the statute. Whether it would be in the class protected by the statute in a proceeding wherein METAL FAB is the bankrupt is a question that is not germaine to this proceeding, particularly since METAL FAB is not involved herein.

In order to further clarify the issues involved in this appeal Appellant will divide the types of creditors into two classes:

(1) Creditors of FELDEN who are not also creditors of METAL FAB;

(2) Creditors of FELDEN who are also creditors of METAL FAB.

Assuming, for purpose of example only, and not for any other purpose, that by virtue of Section 70 (C) of the Bankruptcy Act, the Trustee (Appellee) has been vested with all the rights, remedies, and powers of a creditor of FELDEN, let us analyze what are the rights of the two classes of creditors.

Class (1) creditors (creditors of FELDEN who are not also creditors of METAL FAB) would have absolutely no standing to challenge the validity of the chattel mortgage since Class (1) creditors are not "creditors of the Mortgagor" within the purview of Section 2957 of the CALIFORNIA CIVIL CODE. Talcott v. Hurlbert, 143 Cal. 4, 76 Pac. 647 (1904).

Class (2) creditors (creditors of FELDEN who are also creditors of METAL FAB, such as CYCLONE SANDBLAST EQUIPMENT COMPANY) became creditors prior to the purchase-sale agreement between METAL FAB and FELDEN, dated August 29, 1963. There is no evidence in the record to show

that there are creditors of METAL FAB who are also creditors of FELDEN in this proceeding whose claims arose after the purchase-sale agreement of August 29, 1963, while the property was located in San Mateo County. As to those creditors whose claims arose prior to August 29, 1963 (which would include CYCLONE SANDBLAST EQUIPMENT COMPANY) the chattel mortgage is a valid and subsisting lien since the mortgage was recorded in Alameda County as is required by Section 2957 of the California Civil Code. The failure to re-record the mortgage in San Mateo County could not possibly prejudice their position, since at the time they advanced credit to METAL FAB there was a valid and subsisting lien on the chattels in the form of the chattel mortgage which was recorded in the County of Alameda, the locus of the property while in the possession of METAL FAB.

Appellant has shown that as to Class (1) creditors the Trustee would have no standing to challenge the validity of the mortgage, for in no sense are they "creditors of the mortgagor".

As to Class (2) creditors the Trustee does not have a standing to challenge the chattel mortgage, because if he "steps into the shoes" of the creditors he puts himself in the position of being a creditor who could not challenge

the validity of the chattel mortgage by reason of the fact that as to those creditors the mortgage was a valid and subsisting lien on the mortgage property.

APPLICABILITY OF TALCOTT v. HURLBERT

Appellee has gone to great lengths to distinguish the decision in Talcott v. Hurlbert, 143 Cal. 4, 76 Pac. 647 (1904). This case was cited for the proposition that the words "creditors of the Mortgagor", as used in CALIFORNIA CIVIL CODE, Section 2957, meant creditors of the Mortgagor and not creditors of the assignee of the Mortgagor. A close reading of the decision will show that this construction of the statute was the grounds of decision. The case was not decided on the grounds that there were no creditors of the Mortgagor before the Court as the Appellee would lead you to believe. The heart of the decision reads as follows:

> "It is clear, under the above section (Section 2957, CALIFORNIA CIVIL CODE,) that the mortgage to Hall was void as to any creditor or creditors of the Mortgagors Hurlbert and Woolfolk. But it was not void except as to the classes of persons named in the section. Here there is no creditor of the Mortgagors before the Court as such. We cannot extend the words of the statute to parties not included in the classes named in it. The corporation succeeded to the property

mortgage, but this did not make the corporation a mortgagor". . . . (emphasis added).

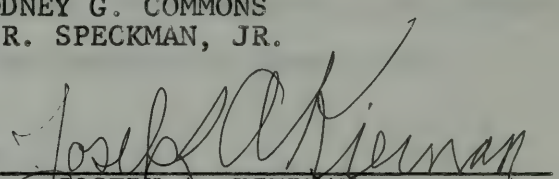
CONCLUSION

For the reasons stated, it is respectfully submitted that the District Court's Order adopting the Order of the Referee in Bankruptcy dated January 12, 1965, be reversed and the Chattel Mortgage be declared a valid and subsisting lien on the property.

DATED: April 22, 1966.

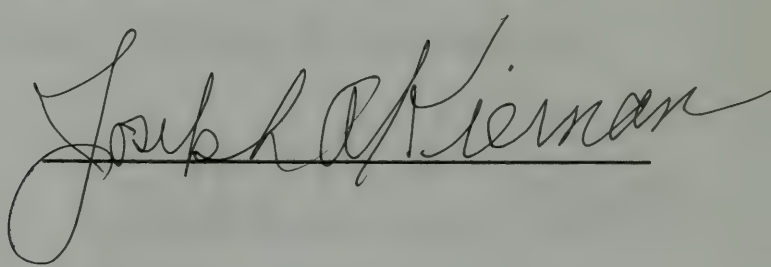
Respectfully submitted,

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By 
JOSEPH A. KIERNAN
Attorneys for Appellant.

CERTIFICATE

I hereby certify that in connection with the preparation of this Brief I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Brief is in full compliance with those rules.



PROOF OF SERVICE BY MAIL

STATE OF CALIFORNIA)
CITY AND COUNTY OF SAN FRANCISCO) SS.

I am a citizen of the United States and a resident of the County aforesaid; I am over the age of eighteen years and not a party to the within action; my business address is:

405 Montgomery Street
San Francisco, California 94104

On April 22, 1966, I served the within OPENING BRIEF FOR APPELLANT on the interested parties in said action, by placing a true copy thereof in a sealed envelope with postage thereon fully prepaid, in the United States mail addressed as follows:

ROTHSCHILD & PHELAN
155 Montgomery Street
San Francisco, California, 94104

I certify (or declare) under penalty of perjury that the foregoing is true and correct.

Executed on April 22, 1966, at San Francisco, California.

Joseph A Kiernan

NO. 20035

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

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Appellee.

REPLY BRIEF FOR APPELLEE

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FILED

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REPLY BRIEF FOR APPELLEE

INTRODUCTION

The Referee, who was affirmed by the District Court held a chattel mortgage in favor of Appellant to be invalid against the trustee in bankruptcy under Section 70(c) of the Bankruptcy Act. The mortgage in question was held invalid under Section 2957 of the California Civil Code, which secti has now been repealed but was in effect at the time of the transaction and at the time of the Referee's decision. The decision of this Honorable Court may well be the last appel-

late decision involving Section 2957 of said Civil Code.

The property covered by the chattel mortgage was moved from Alameda County to San Mateo County and the appellant mortgagee failed to record the mortgage in San Mateo County, which the Civil Code required in the absence of the filing of a statement of recordation with the Secretary of State.

STATEMENT OF FACTS

The statement of facts set forth by Appellant is incomplete to a material degree. The following statement of facts is provided so that all of the facts of the case will be before the Court.

On July 31, 1963, METAL FAB ENTERPRISES, INC., (hereinafter called METAL FAB) which had its principal place of business in the County of Alameda, State of California, executed a promissory note and a chattel mortgage (Exhibit 2) in favor of UNITED CALIFORNIA BANK (hereinafter called Appellant) covering certain personal property then located in Alameda County. The chattel mortgage was recorded in Alameda County on August 2, 1963.

On or about August 29, 1963, FELDEN INDUSTRIES, INC., the bankrupt herein (hereinafter called the Bankrupt) purchased the assets of METAL FAB and assumed its liabilities (Tr. 6-7, Supp. Tr. 3-5), leaving METAL FAB with at most a hollow corporate shell. At least one of METAL FAB's creditors did not release METAL FAB of its obligations,(Supp.Tr.10) so that all who were credito

of METAL FAB and did not release METAL FAB, remain creditors of METAL FAB despite the assumption of liabilities by the bankrupt. By reason of the assumption agreement they are also creditors of the Bankrupt.

The acquisition of the assets and assumption of the liabilities of METAL FAB by the Bankrupt were closely scrutinized by a creditors' committee of METAL FAB. (Tr. 13.) While Appellant was not a member of that creditors' committee, Appellant did attend meetings of the creditors' committee, and was in agreement with and fully informed as to the transfer of METAL FAB's assets to the Bankrupt and the assumption of the liabilities of METAL FAB by the Bankrupt. (Tr. 13; see also Tr. 19.)

The assets so acquired were moved by the Bankrupt to its premises in Menlo Park, San Mateo County, within approximately two weeks of the date of acquisition and remained in San Mateo County at the time of the filing of the petition in bankruptcy by the Bankrupt. (Tr. 7, 11.) The chattel mortgage was never recorded in the County of San Mateo, nor was a statement of recordation ever filed with the Secretary of State of California as required by statute, although such recordation or filing would have fully protected Appellant. Appellant negligently permitted a secret lien to arise. (Tr. 8.)

The following facts were omitted by Appellant in its Brief, yet are determinative of this case. Prior to assumption of the liabilities of METAL FAB by the Bankrupt,

METAL FAB was indebted to CYCLONE SANDBLAST EQUIPMENT COMPANY (hereinafter referred to as CYCLONE). (Supp. Tr. 8-10.) At the time of the assumption of liabilities of METAL FAB by the Bankrupt, CYCLONE remained a creditor of METAL FAB and became a creditor of the Bankrupt. (Supp. Tr. 7, 8-10, Exhibit 1.) CYCLONE was not aware of the existence of the mortgage and was a creditor of the bankrupt up to and including the date of bankruptcy. (Supp. Tr. 10.) CYCLONE at no time released METAL FAB from its debts and to date remains a creditor of METAL FAB. (Tr. 10.)

Therefore CYCLONE was a creditor of the Bankrupt who was a creditor of the mortgagor at the time of the execution of the mortgage.

The Bankrupt voluntarily filed a petition in bankruptcy on July 14, 1964. The trustee subsequently filed an application for an order determining the lien of Appellant to be invalid as against the estate of the Bankrupt and on December 17, 1964, the Referee entered his order granting the trustee's application and declaring the chattel mortgage to be invalid as against the trustee. The District Court affirmed the Referee's order and the appeal is from this order.

THE BASIS OF THE TRUSTEE'S RIGHTS

The trustee's rights are derived principally from the provisions of Section 70(c)* of the Bankruptcy Act and from a

*"The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

United States Supreme Court in Moore v. Bay, 284 U.S. 4, 76 L. Ed. 133.

The United States Supreme Court in Moore v. Bay and subsequent decisions uniformly holds that the trustee is subrogated to the rights of any actual creditor of the bankrupt even though those rights would not otherwise be enjoyed by all creditors of the bankrupt. If a security interest, at the time of bankruptcy, is void as against one creditor, then it is void as against the trustee.

The present security interest is void, under California law, as against one creditor of the bankrupt, to wit, CYCLONE, and therefore it is void as against the trustee.

THE CHATTEL MORTGAGE IS INVALID AS AGAINST AN EXISTING CREDITOR OF THE BANKRUPT

CYCLONE SANDBLAST EQUIPMENT COMPANY was a creditor of the Bankrupt at the time of the filing of the petition in bankruptcy and its claim remains unsatisfied. (Supp. Tr. 8-9) CYCLONE was a creditor of the mortgagor, METAL FAB, prior to execution of the mortgage by METAL FAB (Supp. Tr. 8-9; Claim No. 54), and at all times thereafter. (Supp. Tr. 10.) CYCLONE did not release METAL FAB of its obligation. (Supp. Tr. 10.) At no time did CYCLONE have knowledge of the existence of the chattel mortgage. (Supp. Tr. 10.)

The chattels were moved to San Mateo County shortly after they were transferred to theBankrupt. (Tr. 7, 11.) The chattel mortgage was never recorded in San Mateo

County and Appellant did not avail itself of its right to file a statement of recordation with the Secretary of State pursuant to Civil Code Section 2957, (Tr. 8, App. Opening Brief, p.3.) which would have protected it no matter to what county the mortgaged property was removed.

A chattel mortgage is valid as against creditors of the mortgagor and others, if it is recorded in the county in which the chattels are located. (Civil Code §2957)* This protection continues only so long as the chattels remain in the county in which the mortgage is recorded. If the chattels are removed to another county, the protection ceases. This is true, whether or not the mortgagee learns that the chattels have been moved. However, Appellant knew and participated in the transfer of assets from METAL FAB to the Bankrupt (Tr. 13) and so knew that the removal of chattels was imminent, and certainly was aware of the removal when it signed the assumption agreement. (Exhibit 1) Even after that date Appellant did not record in San Mateo County.

* "A mortgage of personal property or crops is void as against creditors of the mortgagor and subsequent purchasers and encumbrancers of the property in good faith and for value, unless The mortgage, if of personal property other than crops growing or to be grown or animate personal property, is recorded in the office of the recorder of each of the counties where the property mortgaged is located and where the mortgagor resides at the time the mortgage is executed, provided that in case the mortgagor is a nonresident of this State no recordation where the mortgagor resides is required, and, in case the property

Naturally, the Legislature has provided a method by which a mortgagee can continue the perfection of the chattel mortgage in the event the chattels are removed to another county. In fact, the Legislature has provided three alternative methods. A mortgagee may adopt the method which is the most convenient. Under Civil Code Section 2957, a mortgagee may, upon removal of the chattels to another county, reperfect the mortgage by one of three methods. The mortgagee may:

(1) Rerecord the mortgage in the county to which the chattels are moved.

(2) At any time after the mortgage is executed, file with the Secretary of State a statement of recordation.

(3) Take possession of the property, and sell it as authorized in Civil Code Section 2966. (Civil Code §2965)**

* mortgaged is thereafter removed to another county of this State, either the mortgage is recorded in that county or there is or has been filed a statement of recordation as prescribed in Section 2965;...." (Civil Code, §2957.)

** "When personal property mortgaged...is removed from the county in which it is situated, constructive notice of the mortgage imparted by recordation shall not be affected thereby for 30 days after such removal; but after the expiration of such 30 days, said recordation shall not impart constructive notice while said property remains removed from the county: (1) Until the mortgagee causes the mortgage to be recorded in the county to which the property has been removed; or (2) Unless the mortgagee causes or has caused a statement of recordation to be filed; or (3) Until the mortgagee takes possession of the property as prescribed in the next section. The statement of recordation shall be filed with the Secretary of State, signed by the mortgagee, stating that a mortgage of personal property has been recorded, the kind or kinds of personal property mortgaged, recording data as to permit the record to be located, and the name and chief place of business of each of the mortgagor and mortgagee...." (Civil Code, §2965.)

The statement of recordation referred to above is simply a statement, signed by the mortgagee, stating that a mortgage of personal property has been recorded. The statement includes the kinds of personal property mortgaged, the recording data to permit the record to be located, and the name and chief place of business of the mortgagee and mortgagor.

The statement of recordation is foolproof protection to the mortgagee which relieves him of the burden of keeping track of the mortgaged property. If the mortgagee files this simple statement with the Secretary of State, the property may be moved from county to county without prejudicing his rights.

Any prudent mortgagee of personal property would obviously file a statement of recordation with the Secretary of State as to each chattel mortgage. The failure to do so constitutes an assumption of the burden of watching the property and rerecording in another county if the property is moved.

Appellant failed to avail itself of the simple protection offered by statute - protection designed to enable mortgagees to relax and forego periodic surveillance of the chattels. Having failed to take ordinary caution and having failed to pursue any of the several protective courses provided by statute, Appellant can hardly complain that a creditor of the mortgagor, CYCLONE, is thus enabled to set aside the chattel mortgage.

Appellant is in no position to complain that the statutes should not be followed exactly or that the Legislature might have devised a scheme more likely to impart actual notice to certain creditors. The recording statutes are very precise and they require, upon removal of chattels to another county, recordation of the mortgage in the county to which the chattels were moved, unless the mortgagee has elected to file a statement of recordation.

Appellant appears critical of the method established by the Legislature to provide notice to creditors. The California Supreme Court has held, while considering the very statute at hand, that "(W)hat is 'notice to the world' must be and is committed to the legislative judgment." (Hopper v. Keys, 152 Cal 488, 494) The California Supreme Court indicates in its opinion that some states hold that recordation of the mortgage in the county in which the chattels are located is "notice to the world", even if the chattels are subsequently moved. However, California has decided, by statute, that such recordation is not notice after the chattels have been moved.

The California Supreme Court in Hopper v. Keys, supra, indicated that the procedure established by the Legislature is inflexible and is "indispensably necessary to preserve the rights of the mortgagees against creditors...." (152 Cal at 494-5) The court continued:

> "In fact, the language of Section 2965 of the Code is so plain and unambiguous that construction is unnecessary. The failure of the appellants to do either of the things in Sonoma County required by that section had the effect, in our opinion, of exempting ipso facto, the property from the operation of the mortgage, so far as it affected creditors of the mortgagor."
> (at 152 Cal. 495) (emphasis added)

The Court pointed out that recordation is a substitute for manual delivery and that "all rights accruing by virtue of such mortgages can be protected and preserved only by fully meeting the requirements of the statute and strictly observing its provisions." (152 Cal. at 493) The California Supreme Court notes the strong policy of the law against secret liens "and that mortgages of personal property are permitted only in certain specified cases, and then only upon the observance of certain formalities...." (152 Cal. at 494) (emphasis added)

Appellant contends, beginning at the bottom of page 13 of its Brief, that even if the mortgage had been recorded in San Mateo County, it would not have imparted notice to creditors of the Bankrupt. We note from the above discussion that strict compliance with the recording statutes is required and that it does not matter whether the recordation would have imparted notice to creditors of the Bankrupt.

However, recording of the chattel mortgage in San Mateo County would in fact have imparted notice to creditors of the Bankrupt who knew of the transfer of assets of METAL FAB to the Bankrupt. Such creditors, when checking the

San Mateo County Recorder's Office for recordation of a chattel mortgage, would check both in the name of the Bankrupt and in the name of METAL FAB and so learn of the existence of the chattel mortgage. Thus, Appellant's contention that such recordation would be futile is erroneous.

It is important to note that under Civil Code Section 2957, a chattel mortgage not properly recorded (in the absence of a properly filed statement of recordation) is "void as against creditors of the mortgagor...." CYCLONE was and still is a creditor of the mortgagor, METAL FAB. In the decision relied upon by Appellant (Talcott v. Hurlbert (1904) 143 Cal. 4) there was no "creditor of the mortgagor" at the time in question, by reason of a release of the mortgagor by his creditors, and therefore the statutory requirement was not met. The case of Talcott v. Hurlbert , relied upon by Appellant, is for that reason inapplicable.

CYCLONE had no actual notice of the mortgage and, by reason of Appellant's failure to comply with the requirements of Civil Code Section 2957, had no constructive notice. The mortgage became a secret lien after the chattels were moved.

There can be no question that Section 2957 applies to CYCLONE, as CYCLONE was a creditor of the mortgagor prior to execution of the mortgage and such prior creditors are protected. As stated at 1 Witkin, Summary of California Law, pp. 685-686:

moved.

"The defective mortgage is void as against subsequent creditors of the mortgagor without notice, and subsequent purchasers and encumbrancers in good faith, for value, and without notice. (CC §2957, 2973.) (Cf. Unif. Com. C. §9-301.) It is also void as against all prior creditors of the mortgagor, even if they had actual notice. Under CC §2973, the mortgage is valid as to persons who have actual notice before parting with value. The prior creditors, i.e., those who have extended credit before the execution of the mortgage, are no longer in a position to withhold that credit, and hence are entitled to protection regardless of whether they have notice of the invalid mortgage. (Old Settlers' Inv. Co. v. White (1910) 158 C. 236, 110 P. 922; Noyes v. Bank of Italy (1929) 206 C. 266, 274 P. 68; Rolando v. Everett (1946)72 C.A. 2d 629, 165 P. 2d. 33; see 19 So. Cal. L. Rev. 444.)"

The California Supreme Court has construed Section 2957 as applied to existing creditors. (Noyes v. Bank of Italy, 206 Cal. 266) This court has recognized and applied the construction of the California Supreme Court in its decision in Bank of America v. Sampsell, 114 Fed. 2d. 211, 212. "The California courts have construed the general chattel mortgage recording statute...in para materia with Section 3440 of the Civil Code as requiring an immediate recording. Failure promptly to record renders the mortgage invalid as against all creditors who become such prior to the date of recording." There can be no doubt that the mortgage was invalid as against CYCLONE.

THE CHATTEL MORTGAGE IS INVALID AS AGAINST THE TRUSTEE

Having established that the mortgage is invalid as against CYCLONE and noting further that CYCLONE was an

actual creditor of the Bankrupt as of the date of bankruptcy, it necessarily follows that the mortgage is invalid as against the trustee.

Appellant devotes all of its energies to demonstrating that the trustee cannot successfully rely upon the rights of a hypothetical creditor. The trustee did not rely upon the rights of any hypothetical creditor and the Referee did not base his decision upon such a ground.

This Court, in a recent opinion, (Pacific Finance Corporation v. Edwards (1962) 304 F. 2d. 224, 228.) redeclared that under Bankruptcy Act Section 70(c) the trustee succeeds to the rights of an actual creditor of the bankrupt whether or not that creditor actually obtained a lien upon the property of the bankrupt. It is enough that the actual creditor could have obtained a lien. Under the California attachment and execution laws, CYCLONE could have obtained such a lien.

While there has been considerable discussion and some confusion in recent years as to the limits of the ability of the trustee to succeed to the rights of a hypothetical creditor, the United States Supreme Court and other Federal courts have held that the trustee succeeds to the rights of an actual creditor. (Moore v. Bay, 284, U.S. 4, 76 L. Ed. 133, Zamore v. Goldblatt, 194 F. 2d. 933, 934-935.)

In Zamore v. Goldblatt, supra, the Court of Appeals for the Second Circuit met the question head on:

> "It is argued by the appellants that the trustee could not attack the mortgage because he represented only one small creditor whose claim arose before the date of the filing but one creditor who could attack it was enough to void the mortgage under Section 70, sub. c of the Bankruptcy Act, 11 U.S.C.A. §110, sub. c, against later creditors represented by the trustee. Moore v. Bay, 284 U.S. 4, 52 S. Ct. 3, 76 L. Ed. 133; In re Sachs, 4 Cir. 30 F. 2d 510, 514, 515; City of New York v. Rassner, 2 Cir. 127 F. 2d 703, 707." (194 F. 2d at 934, 935.) (emphasis added)

In City of New York v. Rassner 127 F. 2d 703, 707, the court also distinguished between the rights of creditors generally and the rights of a particular creditor:

> "It is true that the chattel mortgages were valid as against the bankrupt. But in many cases chattel mortgages are valid as against some creditors and not others; and yet ever since Moore v. Bay, 284 U.S. 4, 52 S.Ct. 3, 76 L.Ed. 133, 76 A.L.R. 1198, it has been considered proper to invalidate a mortgage in toto even though the only creditor entitled to invalidate has an insignificant claim, and proper to distribute the proceeds among all the creditors. See General Motors Acceptance Corp. v. Coller, 6 Cir., 106 F.2d 584, certiorari denied 309 U.S. 682, 60 S.Ct. 723, 84 L.Ed. 1026; Corley v. Cozart, 5 Cir., 115 F.2d 119

In Corley v. Cozart, 115 F. 2d 119, the court held:

> "A claim void as against some of the creditors of a bankrupt may be avoided in its entirety by the trustee even though creditors generally benefit by the avoidance. [citations]" (115 Fed.2d at 121.)

While innumerable other cases may be found supporting the succession by the trustee, under Section 70(c), to the rights of an actual creditor of the bankrupt, further examples would merely be cumulative. Appellant has not and cannot answer the doctrine enumerated by the United States Supreme Court in Moore v. Bay, but instead relies upon the irrelevant discussion of the rights of hypothetical creditors.

INAPPLICABILITY OF TALCOTT v. HURLBERT

Appellant relies upon the decision in Talcott v. Hurlbert, 143 Cal. 4 (1904). That decision is not controlling in this case.

The decision in Talcott v. Hurlbert arose under the old California Insolvency Law. The purchaser of the mortgaged property had been adjudged insolvent and an assignee was appointed. As the Court noted (143 Cal. at p. 7), "The assignee (i.e., the assignee of the insolvent party) can be allowed no greater rights than the corporation would have had in the case." By contrast, under Section 70c of the Bankruptcy Act, the trustee in bankruptcy is entitled to greater rights than the bankrupt. The trustee succeeds to the rights of creditors of the bankrupt.

In Talcott v. Hurlbert, the creditors of the mortgagor, upon assumption of the mortgage by the assignee of the mortgagor released the mortgagor of its debts. Thus, in that case there were in fact no "creditors of the mortgagor" as required under Section 2957 of the Civil Code. In the present case one of the creditors of the mortgagor, to wit, CYCLONE, did not release METAL FAB, the mortgagor. Thus, in this case there remains a creditor of the mortgagor as required by the statute.

Because there was no creditor of the mortgagor who could object to the unrecorded mortgage in Talcott v. Hurlbert,

the case was determined upon that fact and the remainder of the decision constitutes dicta.

The result reached by the Referee, and affirmed by the District Court, is consistent with decisions reached under similar facts, although by different reasoning, by the Court of Appeals for the Second Circuit in the case of In re Rambler Cafeteria, Inc., 9 Fed.2d 831, and by the Court in Fidelity Trust Co. v. Staten Island Clay Co., 70 N.J. Eq. 558, 62 Atl. 441.

CONCLUSION

The trustee, appellee herein, submits that the facts conclusively establish the following points:

1. The chattels subject to the chattel mortgage were moved from Alameda County to San Mateo County and no steps were taken, as required by statute, to continue the perfection of the chattel mortgage.

2. By reason of the failure of Appellant to continue the perfection of the mortgage by re-recording the mortgage or by filing a statement of recordation, the mortgage was void as to "creditors of the mortgagor."

3. Cyclone was a "creditor of the mortgagor."

4. The mortgage was void as against Cyclone.

5. Cyclone is a creditor of the bankrupt.

6. The mortgage is therefore void as against the trustee, the appellee herein.

The appellee respectfully submits that the order of the Referee, affirmed by the District Court, is correct in all respects and that the order of District Court sustaining the Referee should be affirmed.

DATED: March 28, 1966

Respectfully submitted,

AUGUST B. ROTHSCHILD
WILLIAM KELLY
ROTHSCHILD & KELLY

By August B. Rothschild
August B. Rothschild
Attorneys for Appellee

C E R T I F I C A T E

I hereby certify that in connection with the preparation of this Brief I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Brief is in full compliance with those rules.

August B. Rothschild

AFFIDAVIT OF SERVICE

UNITED STATES OF AMERICA)
NORTHERN DISTRICT OF CALIFORNIA) ss.
CITY AND COUNTY OF SAN FRANCISCO)

WILLIAM KELLY, being first duly sworn, deposes and says:

I am a citizen of the United States over the age of 18 years and not a party to the within above entitled action; my business address is 155 Montgomery Street, San Francisco, California.

On March 28, 1966, I served the within REPLY BRIEF FOR APPELLEE upon the persons named hereafter by placing a true copy thereof enclosed in a sealed envelope with postage thereon fully prepaid in the United States Post Office mail box at San Francisco, California, addressed as follows:

JOHN K. DERHAM
JOSEPH A. KIERNAN
RODNEY G. COMMONS
PAUL R. SPECKMAN, JR.
405 Montgomery Street
San Francisco, California 94104

WILLIAM KELLY

WILLIAM KELLY

Subscribed and sworn to before me this 28th day of March, 1966.

(Seal)

FRANCES R. WIENER
NOTARY PUBLIC
In and for the City and County of San Francisco, State of California.
My Commission expires: February 17, 1970.

No. 20,037

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Secretario
Vol. 3352

SECRETARY OF HEALTH, EDUCATION
AND WELFARE,

Appellant

v.

LUCY MEZA,

Appellee

ON APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE SOUTHERN DISTRICT OF
CALIFORNIA

PETITION OF APPELLANT FOR REHEARING

J. WILLIAM DOOLITTLE,
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SEP 20 1960

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 20,037

SECRETARY OF HEALTH, EDUCATION AND WELFARE,

Appellant

v.

LUCY MEZA,

Appellee

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALIFORNIA

PETITION OF APPELLANT FOR REHEARING

The Secretary of Health, Education and Welfare, appellant in the above-styled cause, respectfully petitions for a rehearing of the judgment of this Court entered on August 31, 1966. The basis for this petition is as follows:

1. This action was brought by the appellee, Lucy Meza to review the final decision of the Secretary denying her claim for social security benefits, which claim was based upon the

alleged presumed death of her ex-husband, Domingo Meza. The Secretary's denial of the claim was based on his finding that there was no evidence of death and that the absence of Domingo for more than 7 years was not an unexplained absence. In its opinion and judgment of August 31, 1966, this Court affirmed th determination of the district court that the Secretary's decisi was not supported by substantial evidence and that Domingo Meza death must be presumed.

2. On the same date that this Court's opinion and judgmen were rendered, but before notification of that decision and judgment was received by us, we were advised by the Department of Health, Education and Welfare that the Appeals Council of that Department had just been furnished with information to the effect that an application for retirement insurance benefit had been filed in Houston, Texas by a Domingo Meza. It was lat disclosed that this application had been filed on July 5, 1966, and that on the following day, applications for wife's and chil insurance benefits had been filed by one Amelia Montoya Meza, who represented herself to be the wife of Domingo Meza.

Upon receipt of the advice from the Appeals Council that Meza apparently had filed an application, we requested prompt documentary verification. On the following day, September 1, 1966, when it became apparent that it might be a matter of several days before the documents would be received from the

epartment of Health, Education and Welfare, J. F. Bishop, one f the attorneys of record for the Secretary in this Court, elephoned the Clerk of the Court to alert him to the fact that he Secretary probably would be filing supplemental papers in onnection with the pending appeal. Mr. Bishop was informed by he Clerk that this Court's decision, affirming the judgment of he district court, had been rendered on the previous day.

3. On the basis of documents in the possession of the epartment of Health, Education and Welfare, copies of which are eing filed with the Clerk of this Court and served upon counsel or the appellee together with this petition for rehearing, it ppears reasonably certain that the Domingo Meza who filed the pplication for retirement insurance benefits in Houston on uly 5, 1966 is the husband of the appellee in this case. For his reason, we respectfully submit that the judgment of this ourt should be vacated and the cause remanded to the district ourt with instructions to remand the matter, in turn, to the epartment of Health, Education and Welfare for a reopening of he administrative proceedings on Lucy Meza's claim for benefits ased upon Domingo's purported death.

a. In his application for retirement insurance benefits, omingo Meza used the social security number (466-05-2142) which as the administrative transcript on file in this Court reflects Tr. 1)) was assigned to appellee's husband. In connection with

that application, Domingo Meza submitted a statement which explains the reason why his social security employment record did not reflect earnings after 1954. Meza stated that he had been "a self-employed caddy for about 9 years" but had "never filed a self-employment tax return as I had no idea I was supposed to."

b. When Meza's July 5 application was processed at Baltimore, Maryland, it was discovered that there was a pendi death claim (i.e., Lucy's) on the same social security account As a result, the Houston office of the Social Security Adminis tion was requested to make further inquiry. On July 25, 1966, an additional statement was obtained from Domingo Meza in Hous In that statement, Meza first referred to his marriage to Amel Morales and to his divorce from her in Harris County, Texas o May 14, 1945 (which, as this Court's August 31, 1966 opinion reflects, is corroborated by the record.) Meza then went on discuss his marriage to "Lucy Estrada" (i.e., the appellee) i November, 1945 and his leaving her in 1948. In this regard, stated that "[w]e had a quarrel and I left. One child was bo before I left--Juanita. The other child was born after I lef I have not heard anything else about them."

Finally Meza discussed his purported marriage in 1958 to Emily (Amalia) Montoya (which is evidenced by a marriage certificate furnished to the Social Security Administration).

ccording to Meza, Emily was aware of his first marriage (to melia Morales) but "does not know about Lucy. I did not tell er because there had been no divorce and it was something I referred to forget. I never got a divorce because it would ave been too much trouble to travel to California and get the ivorce." 1/

4. While, as above noted, we believe that there can be ittle question that this documentary matter discloses that ppellee's husband is still alive, any doubt that might exist ith respect to the authenticity of the documents should, we elieve, be resolved in the first instance by the Social Security dministration. For this reason, we think that the appropriate ourse of action now would be the vacation of this Court's judgment nd a remand of the proceedings (through the district court) to he Department of Health, Education and Welfare. 2/ Upon the

1/ As the administrative transcript on file with this Court eflects, however, in 1959 Lucy Meza obtained a divorce from omingo in California (Tr. 32-33). It would seem from Domingo's uly 25, 1966 statement that he was unaware of this fact.

2/ Section 205(g) of the Social Security Act, 42 U.S.C. 405(g), mpowers a district court "at any time, on good cause shown, to] order additional evidence to be taken before the Secretary." e submit that newly discovered evidence of the type here nvolved clearly constitutes such "good cause." Appellee is, of ourse, not entitled to benefits based upon Domingo's death if, s now appears, Domingo is still alive. Moreover, if the ecretary were required to pay benefits on the basis of Domingo's rported death, it is doubtful whether, at the same time, he ould pay retirement benefits to Domingo on the basis of his ontinuing life. Yet, notwithstanding his misconduct in his arital relationship with appellee, Domingo is entitled to eceive retirement benefits if he is still alive and has met he eligibility requirements.

remand, appellee would, of course, have the opportunity to challenge, if there is any basis for doing so, the truth of the representations made in the statements recently given to the Social Security Administration by Domingo Meza.

CONCLUSION

For the foregoing reasons the appellant respectfully requests that the Court grant this petition for rehearing, and that it vacate its decision and judgment of August 31, 196 and remand the cause to the district court with instructions to remand further to the Secretary.

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Washington, D.C. 20530.

SEPTEMBER 1966

CERTIFICATE OF COUNSEL

I hereby certify that the foregoing petition for rehearin is, in my judgment, well founded and is presented in good fai and not for the purposes of delay.

J. F. BISHOP
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Washington, D.C. 20530
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No. 20038

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

RORY EVERETT PAGE, CHARLES L. HOPE, BEVERLY JO PAGE, and BONEVA L. HOPE,

Appellants,

vs.

U.S. DIVERS CO., INC., a California corporation,

Appellee.

APPELLANTS' REPLY BRIEF.

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No. 20038

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

RORY EVERETT PAGE, CHARLES L. HOPE, BEVERLY JO PAGE, and BONEVA L. HOPE,

Appellants,

vs.

U.S. DIVERS CO., INC., a California corporation,

Appellee.

APPELLANTS' REPLY BRIEF.

I.

Appellee Concedes That Page Both Recognized and Solved the Safety Problem of the Aqua-Lung.

The Page invention is a safety improvement in the Aqua-Lung, and more specifically, it relates to undesired water which is present within the breathing circuit of the equipment, and to minimizing the interference thereby created with the necessary breathing action of the diver (App. Op. Br. pp. 2, 8, 9, 13-15). The then existing safety problem and attendant danger of drowning were prominently mentioned in the original Page patent application filed on March 29, 1954 [Ex. 3, p. 1, line 18, to p. 2, line 13, incl.]

About the same day that the Page patent application was filed, Hope-Page Engineering Corporation published its first advertisement on the "Safety First Non-

Return Valve" [Ex. 12]. On the following day, March 30, 1954, Mr. Rene Bussoz, then president of U.S. Divers Corporation, wrote to Hope-Page Engineering Corporation as follows:

> "We saw in the recent issue of 'The Skin Diver' magazine your advertisement on your new Safety First Non-Return Valve and became interested in this item". [Ex. 35].

Appellee in its brief carefully avoids mentioning the word "safety". Nevertheless, by its silence, it concedes that the safety problem as described in the Page patent did exist, and also that Page was the first to recognize that problem and was successful in solving it. Appellee's position could hardly be otherwise in view of the uncontradicted testimony of the diving experts, Professor Tillman [Tr. pp. 27-47] and Bevly Morgan [Tr. pp. 125-159], and Finding of Fact No. 8 [R. pp. 92, 93].

Invention may consist of recognizing that a specific cause precludes the achievement of maximum usefulness of a prior art device, regardless of whether subsequent construction of the improved apparatus requires further use of the inventive faculty. *In re Pennington* (CCPA, 1957), 44 CCPA 789, 241 F. 2d 750, 754, 113 USPQ 81, 85. That rule appears to be controlling in this case, since after many years of wide usage of the Cousteau Aqua-Lung Page alone was able to recognize that the apparatus had a deficiency which perhaps could or should be remedied.

It is an undenied fact that thousands of divers today are using the apparatus manufactured and sold by appellee U.S. Divers, and in so using the apparatus are achieving the safety benefits originally conceived and provided by Page.

II.

Appellee Concedes the Novel Cooperative Functioning of the Page Apparatus.

Appellants in their opening brief (pp. 22-25) described the acts of invention involved in Page's pioneering work. Appellee in its brief (p. 21) simply replies "all of this is irrelevant".

Appellants in their opening brief (pp. 28-34) also summarized the novel cooperative functioning of the Page apparatus. Appellee in its brief (p. 21) simply replies: "It is irrelevant and has nothing to do with the merits of the case." And at the same time appellee accuses Page of "an elaborate pseudo-scientific explanation" of his invention. In this connection it is worthy of note that Page is presently employed as a project engineer in our Nation's space program [Tr. p. 273, line 12, to p. 274, line 18]. The Court can take judicial notice of the fact that in the design and manufacture of space apparatus the crucial requirement is safe, reliable operation; and in diving equipment used great distances underwater, where the safety of human life is also involved, the same crucial requirement exists. It is therefore quite clear that the action of appellee in characterizing Page's explanation as "pseudo-scientific" but without answering its merits amounts to a concession of its correctness.

Novel cooperative functioning of the Page apparatus compels a finding that the Page patent is valid. See cases cited in appellants' opening brief, page 35; and the earlier decision of this Court in *Coleman v. Holly* (C. A. 9, 1956), 233 F. 2d 71, 78-80; 109 USPQ 204, 209-211; certiorari denied 352 U.S. 952. And to the same effect is the decision just announced by the United States Supreme Court on February 21, 1966, in the case of *United States v. Adams,* 148 USPQ 479, 482-484.

The unsupported assertion of appellee that the novel cooperative functioning of the Page apparatus "is inherent in prior art breathing systems" (Appellee's Br. p. 21) is answered in the following paragraph.

III.

The Prior Art Patents Fail to Anticipate Either the Structure or the Function of the Page Apparatus.

The Page Aqua-Lung is a diving apparatus having a self-contained supply of compressed air, and including four operative valve mechanisms, namely: demand valve 19; non-return inlet valve 34-38; non-return exhaust valve 34'-38'; and flipper valve 28 [Page patent in suit, Ex. 17, Figs. 3 and 9; and see chart, appendix to App. Op. Br.]. The opening and closing actions of the various valve mechanisms in the Page Aqua-Lung take place in response to one or more of three separate and distinct energy sources. These energy sources include: (1) energy resulting from changes in ambient pressure during ascent or descent of the diver; (2) the lungs of the diver; (3) the stored energy of the compressed air supply.

It is therefore seen that in the Page apparatus, where there are four valve mechanisms and three energy sources, there exist twelve distinct possibilities as to whether a particular valve may be actuated by a particular source of energy. When the joint action of two or three of the energy sources is considered, the operation becomes even more complex. None of the prior art patents discloses a comparable apparatus.

Appellee now relies on ten prior patents, and the very fact of having to rely on so many references indicates the weakness of its position. Exhibits 42 and 43, set forth in appellants' opening brief, pages 16 and 17, are helpful in classifying these patents. The Monro, Young, Schwarz, and Rosling patents [Ex. 42] do

not even relate to diving apparatus, and were considered by the Patent Office and cited against the Page patent.

Of the six prior patents which do relate to diving apparatus [Ex. 43] all but the Hensley and Nohl patents had been considered by the Patent Office. These two references add nothing of significance to what is shown in the other eight, and appellee is therefore in the position of directly contradicting the Patent Office determination and the statutory presumption of validity which results therefrom. It is noted that the District Court in its first memorandum opinion [Tr. pp. 73, 74] had no difficulty in holding the Page patent valid over all of the prior art that had been considered by the Court; and in the second memorandum opinion [Tr. pp. 75-78] issued four months later, when the Court had apparently forgotten the evidence in the validity trial, the previous decision was reversed on the basis of the Hawkins patent.

The Hawkins patent was fully considered by the Patent Office, having been called to the attention of the Examiner by the applicant both during the original application proceeding [Ex. 3, p. 64, line 9] and during the reissue application proceeding [Ex. 26, pp. 151, 152]. The testimony showed that the Hawkins device is not even properly considered to be diving apparatus [Tr. p. 963, line 21, to p. 964, line 24]. Furthermore, water could not be successfully discharged from the Hawkins device, because the necessary vertical alignment of the device would cause water in the discharge tube above the discharge valve to run by force of gravity back through the discharge valve to the mouthpiece.

Each of the Lambertson and Nohl patents shows a diving apparatus of the rebreather, or closed circuit type. The rebreather necessarily includes two valves in its breathing circuit, for directionalizing the air flow;

and it will be noted that in the Aqua-Lung this same function is performed by the demand valve 19 and the flipper valve 28 [Ex. 17, Fig. 9]. The rebreather contains no compressed air supply, and the valve operations are actuated only by the lung power of the diver, in conjunction with energy resulting from changes in ambient pressure during ascent or descent. It is readily apparent that the two valve mechanisms and two energy sources of the rebreather are completely inadequate to suggest the complex mode of operation that is involved in the four valve mechanisms and three energy sources of the Page apparatus. Furthermore, the rebreather apparatus incorporates a chemical unit in the breathing circuit for generating oxygen, and the admission of any substantial quantity of water damages the chemical unit and destroys its effectiveness, with possibly the additional result of generating toxic gases; no provision is made for ejecting water because the admission of water into the breathing circuit in the first instance is a forbidden condition of operation. The rebreather is also limited in its usefulness to a depth of about 33 feet [Tr. pp. 203-206, 209, 210].

The Cousteau and Cupp patents relate to diving apparatus that contains its own supply of compressed air, and are admittedly relevant references. As discussed at length in appellants' opening brief, the Page apparatus differs from both Cousteau (pp. 4, 5, 14, 15, 23, 31, 32 and 40) and Cupp (pp. 14, 15, 40 and 41) in numerous respects, and these references utterly fail to teach or suggest the safety feature on which the Page invention is based.

As pointed out in appellants' opening brief, p. 22, the limitations of the Cousteau Aqua-Lung in respect to safety were considered unavoidable by the expert divers of the time, and Page was the first to recognize that modification of the apparatus might be a possible

alternative to training divers in the use of the apparatus as it then existed. Five years after Page conceived his invention the defendant (appellee) glowingly advertised the results of his work in its 1957 catalogue in the following words:

> "Because of the ingenious combination of the two non-return valves, the mere action of breathing will clear the mouthpiece of any water accumulation".

[Ex. 39; U.S. Divers 1957 "Aqua-Lung" catalogue, p. 4, right center]. Of course after the issuance of the Page patent in 1958 this advertisement was discontinued.

It is therefore submitted that Findings of Fact Nos. 7, 9, 10, 18-21, 23-28, and 36 [R. pp. 91-100] are contrary to the evidence.

IV.

The Check Valves Which Page Added to the Aqua-Lung Perform Novel and Unique Functions.

In addition to performing some functions which are old, the check valves which Page added to the Aqua-Lung also perform separate and distinct functions which are novel and unique.

One of the old functions of the check valves 34-38 and 34′-38′ is to directionalize the flow of air within the breathing circuit, but their use for that purpose is superfluous because the air flow was already directionalized [Tr. p. 73, lines 28-32] by the demand valve 19 and flipper valve 28 [in Figure 1 of the Cousteau patent, Ex. B, the demand valve is identified as M and the flipper valve as I]. Furthermore, this duplication would appear undesirable because the dynamic pressure drop caused by the added valves would appear to add to the workload required of the diver's lungs.

Another old function of the check valves in the Page Aqua-Lung, resulting from their placement close to the mouthpiece, is to diminish the intermingling of fresh air with breathed air, and thereby improve the breathing efficiency of the apparatus. Placement of valves close to a mouthpiece for this purpose is taught by the prior art.

The vitally new function of the check valves 34-38 and 34'-38' is to limit the interference of undesired water with the breathable air supply of the diver, and thereby provide safety. The mode of operation is well described in the patent in suit, as quoted in appellants' opening brief at pages 28 to 30. The resulting new mode of operation of the apparatus has completely eliminated the former safety problem [Tr. p. 43, lines 11-21].

The non-return exhaust valve 34'-38' also performs the new function of discharging a mixture of water and air, in variable proportions, and regardless of whether the diver rolls over on his side or not. Page admitted in his testimony that he used a standard gas-mask type of valve in his apparatus. What the prior art fails to show, however, is the use of a gas-mask type valve for discharging water, either in variable proportions, or at all. In view of the fact that the density of sea water is 800 times as great as the density of air at atmospheric pressure [Tr. p. 1,009, lines 5-13], and that the gas-mask type valve has a unique capability for opening by different amounts at different portions of its periphery, this novel use of the gas-mask type valve is highly significant [Tr. p. 428, lines 1-18].

The inlet check valve 34-38 also performs another new function, as explained in appellants' opening brief commencing at the middle of page 32 to the bottom of page 34. This is the function of causing a large part of

the work of closing off the demand valve 19 to be performed by energy derived from the compressed air tank, rather than by energy furnished from the lungs of the diver. Briefly, when the diver is through inhaling and commences to exhale, the force of his exhaled breath causes the inlet check valve 34-38 to close off, thus isolating the diver's lungs from the demand valve 19; the mechanical work of closing off the demand valve 19 so as to conclude the inhale portion of the operating cycle is then done by energy derived from the compressed air tank, while at the very same time the diver is already commencing to exhale through the exhaust tube 26 and discharge valve 28.

V.

In the Page Apparatus the Old (Cousteau) Aqua-Lung Elements Function Differently Than Before.

With inexperienced divers ". . . the problem is always getting air and getting enough air" [Tr. p. 26, line 15, to p. 27, line 12]. In the Cousteau Aqua-Lung the inhale cycle had to be completed by closing off demand valve 19 before the exhale cycle could be initiated by opening flipper valve 28 (App. Op. Br. pp. 31, 32). But in the Page apparatus the diver can discharge the foul air through flipper valve 28 without waiting for the demand valve to close [Tr. pp. 929, 930]. And discharging the foul air does not take as long [Tr. p. 931, lines 23, 24]. Consequently he is ready for the next inhalation of fresh air just that much sooner. And the final closing action of demand valve 19 is accomplished solely by the compressed air with no aid from the diver's lungs.

This new and advantageous mode of operation of the old elements of the Aqua-Lung is an inherent part of the Page safety invention. As this Court has stated:

> "All the uses or functions of an invention are covered and secured by a single patent for that invention, and this includes even those not known to the inventor at the time the patent is granted and must be considered in determining the validity of the patent". *Talon, Inc. v. Union Slide Fastener, Inc.* (C. A. 9, 1959), 266 F. 2d 731, 734, 121 USPQ 249.

VI.
The Page Invention Provides New and Unexpected Results.

One new result which the Page invention provides, which could not have been anticipated by experts working in the field at that time, is that the Aqua-Lung diving equipment is made safe even for novice or amateur divers [Tr. p. 153, line 18, to p. 154, line 7].

Another unexpected result of the Page invention is that, with the addition of the check valves for safety purposes, the workload on the diver's lungs is not only held to tolerable limits but is actually decreased. This results from the fact that the diver no longer has to use his lung power in inflating the air inlet hose, and closing off the demand valve 19, but this work is instead performed by energy derived from the compressed air tank. Page did not originally anticipate this beneficent result [Tr. p. 928, lines 3-17], because of its dependence upon complicated factors of pressure, time, and operating energy. However, he did positively testify at the trial that this is the manner in which the apparatus works [Tr. p. 927, line 16, to p. 931, line 17]. The record contains no contradiction of that evidence.

Finding of Fact No. 29 [R. p. 98] is therefore contrary to the evidence.

VII.
All the Claims Are Valid.

Claims 7 to 18 are directed to a complete diving apparatus, including compressed air supply, pressure regulator, inlet and exhaust hoses, discharge or flipper valve, mouthpiece compartment with mouthpiece, and check valves supported at the ends of the mouthpiece compartment. It is of course the check valves which differentiate the combination here claimed from that of Cousteau.

Claims 7, 9, 10 and 15 are specifically limited to the gas-mask type of valve (shown in Figures 3 to 6, inclusive of the patent) which has a resilient valve member supported at the center of the valve body, so that the various peripheral portions of the valve member can move independently of each other.

Claims 8 to 10 do not expressly recite the compressed air tank and pressure regulator, but incorporate them by reference, in the manner and for the reasons set forth in appellants' opening brief (pp. 9, 10, and 43-45) relative to Claim 9.

Particular attention is directed to Claim 9, which is one of the claims infringed by appellee. Claim 9 was contained in the Page application as originally filed on March 29, 1954, but was then numbered as claim 10. Claim 9 is directed to the underwater discharge of water from the mouthpiece compartment, which as taught by the Page patent is the essence of the Page safety invention. Claim 9 expressly recites the ejection of water from the mouthpiece compartment through the non-return exhaust valve ("Second valve") into the air discharge tube, and it also expressly refers to a mixture of air and water flowing from the compartment into the air discharge tube. While the function of the non-return inlet valve ("first valve") in excluding

water from the inlet hose is not expressly stated, it may be fairly implied from the recitation "said second valve so disposed as to permit ejection of all water entering said tubular body therethrough into an air discharge tube". [Ex. 17, col. 12, lines 22-50]. In other words, the statement in the claim that *all of the water which enters* the tubular body is ejected through the second valve clearly implies that none of that water is permitted to flow through the first valve into the air inlet hose.

Appellee in its brief seems to say that interpreting Claim 9 as reciting the compressed air supply, regulator, and other necessary functioning parts of the Aqua-Lung, is either illegal or improper. In this connection it is most interesting to compare Claim 9 with appellee's 1957 advertisement [Ex. 39, p. 4] which refers to "The Ingenious Combination of the Two Non-Return Valves". But how, one asks, could that combination be ingenious in view of the many prior art patents cited in appellee's brief, pages 18 and 19? The answer is simple. Appellee's advertisement incorporated by reference the old parts of the Aqua-Lung, and attributed ingenuity to the addition of the two non-return valves thereto. And that is exactly what Claim 9 does. Claim 9, of course, was written three years prior to appellee's advertisement.

This narrowed interpretation of Claim 9 was chosen both by Page and by the Patent Office, not only because the language of the claim compels that interpretation, but also because such interpretation of the claim precludes any possible doubt as to its validity. In any event, to thus interpret Claim 9 in the light of the disclosure and of the stated objects of the invention is clearly compelled by the recent Supreme Court decision in the *Adams* case, *supra,* where the Court states:

> "It is true that Claims 1 and 10, supra, do not mention a water electrolyte, but . . . it is funda-

> mental that claims are to be construed in the light of the specifications and both are to be read with a view to ascertaining the invention . . .". *United States v. Adams,* Supreme Court of the United States, 148 USPQ 479 at page 482.

Reissue Claim 15 is narrower in scope in every respect than original Claim 9. Claim 15 positively recites every element of Claim 9, including the compressed air supply and pressure regulator which are incorporated in Claim 9 by reference; and it also defines the structural elements, their interconnections, and their cooperative relationships or functions, in greater detail and with greater clarity than does Claim 9.

Claims 1 to 6 are subcombination claims directed to "underwater breathing apparatus" including a mouthpiece-valve assembly. Claim 5, in particular, claims a new combination of apparatus consisting of a mouthpiece-valve assembly in which gas-mask type valves are used, and which is adapted to be removably coupled to the air hoses in an Aqua-Lung. At least two prior patents would have to be combined to provide the structure of Claim 5, including at least one patent that does not relate to diving apparatus at all. It is submitted that, in view of the new, useful, and unexpected results of the Page invention, to apply hindsight to anticipate the claim in this manner would be unjustified.

Claims 1 to 4 and 6 contain additional limitations which narrow their scope in various respects relative to the scope of Claim 5.

It is therefore submitted that Findings of Fact Nos. 12, 30 and 31 [R. pp. 94, 99] are contrary to the evidence.

VIII.

Appellee Has Deliberately Mis-Labeled the Narrowed Interpretation of Claim 9 as Being Broader.

It is axiomatic in the patent law that every additional limitation recited in a patent claim narrows its legal scope, while the omission of an element broadens the scope of the claim. *In re Reissue Application Papers Executed by Assignee* (Comr. Pat., 1963), 138 USPQ 80. In that case the Commissioner of Patents stated:

> "For the purpose here involved a claim of a reissue application is broader than a corresponding patent claim if it omits any limitation included by such patent claim or in other words, if it would be infringed by any conceivable structure which does not infringe the patent claim, *In re Bostwick,* 26 CCPA 1117, 102 F. 2d 886, 41 USPQ 279; *Fox Typewriter Co. v. Corona Typewriter Co.* 282 F. 502, *Schenk et al v. United Aircraft Corporation,* 51 USPQ 519."

Nevertheless, in deliberate disregard of this fundamental fact of the patent law, the appellee in its brief (p. 27) contends that the incorporation by reference of certain elements in the preamble of Claim 9 has the effect of broadening the scope of that claim. This assertion by the appellee is obviously a bald effort to confuse and conceal the true issues in this case.

IX.

The Purely Technical Defenses Raised to Reissue Claims 11 to 18 Are Not Applicable to the Facts of This Case.

The reissue patent contains the same drawings and the same technical description of the apparatus as were contained in the original patent [Exs. 4, 17]. The only changes accomplished in the reissue were that the

description of the theory of operation of the invention was clarified and enlarged, and claims 11 to 18 were added. All of the added claims 11 to 18 are directed to the same invention as covered by the original patent, namely, the safety improvement of the Aqua-Lung accomplished by the addition of a pair of check valves to the ends of the mouthpiece compartment. More specifically, as pointed in appellants' opening brief, page 37, the reissue Claims 11 to 18 are for the same invention as Claim 9.

The Cousteau patent No. 2,485,039 [Ex. B] was issued in the United States in 1949, and was therefore available to the public. However, in early 1954 neither Page nor his patent attorney was familiar with the Cousteau patent, and the attorney labored through a detailed description of the internal mechanism of the pressure regulator which would have been unnecessary had he known of the Cousteau patent and been able to refer to it by its patent number. This added task detracted from the explanation of the Page invention.

What the reissue claims do is make "clearer and more obvious" how the same apparatus accomplishes the same results in the same manner as set forth in the original patent. This is exactly the purpose of a reissue patent, as is stated in *Minnesota Mining and Mfg. Co. v. Technical Tape Corp.* (CCA 7, 1962), 309 F. 2d 55 at 58, 135 USPQ 176 at 179.

It is evident from the record that appellants' present reliance upon a safety improvement in the Aqua-Lung as constituting the patentable invention "was not the after-thought of an astute patent trial lawyer." (*United States v. Adams,* 148 USPQ 479, 482). The original patent application clearly set forth the safety of the Aqua-Lung as the primary object of the invention; and much of the revision in the reissue patent consisted simply of replacement of the trademark "Aqua-Lung"

with a formal definition of the equipment. The various advertisements published by Hope-Page Engineering Corporation in 1954 were vocal in their elucidation of safety for the Aqua-Lung, often including the phrase "safety with every breath" [Exs. 12, 27, 28, 29, 16, 30 and 31]. The argument that the preambles of the present claims 8, 9 and 10 (then set forth in the claim then numbered as 8) incorporated the old elements of the Aqua-Lung was first advanced to the Patent Office in October, 1955 [Ex. 3, pp. 37-42]. This was months after Bussoz, then president of U.S. Divers, had told Page that his company was changing the design of its equipment and would no longer use non-return valves associated with the mouthpiece [Tr. p. 375, lines 2-17]. It was also months before U.S. Divers came on the market with its Kleer E-Z which of course *does* contain the non-return valves.

Appellee's technical objections to the reissue are largely disposed of by the established law as reflected in the recent decision in *McCullough Tool Company et al. v. Well Surveys, Inc., et al.* (C. A. 10, 1965), 343 F. 2d 381, 145 USPQ 6. One of the patents involved in that case was the Bender Reissue Patent No. Re. 23,226. It was there contended that the reissue claims were not for the same invention as the original patent; however, the Court found that the drawings had remained unchanged, and that the subject matter of the reissue claims was explicitly disclosed and taught but was not claimed in the original patent, and that the reissue claims covered the same invention as disclosed by the original patent. 343 F. 2d pages 388-390.

It was also contended in the *McCullough* case that, due to cancellation of claims 7 and 8 of the original patent application, the statutory requirement of inadvertence, accident or mistake for the reissue patent could not be found to exist. The Court found that the cancelled claims 7 and 8 were "broad enough to include the basic concept of the reissue claims" (343 F. 2d p. 389); but at the same time held that the decision of the Commissioner of Patents upon the question of inadvertence, accident, or mistake, was binding under the rule laid down in *Topliff v. Topliff,* 145 U.S. 156, 171, 12 S. Ct. 825, 831, 36 L. Ed. 658.

Appellee in its brief has attempted to make much of the cancellation of claims 17, 18, and 22 of the original Page patent application. However, it clearly appears from the record [Ex. 3, pp. 67-86] and from the testimony of Mr. Hall [Tr. pp. 974-977] that all three of these claims were broader in scope than the claims subsequently added in the reissue proceeding; that claim 17 (together with claim 18 dependent thereon) was defective in failing to recite any connection by which the pressure-sensitive valves were supported; and that claim 22 had been refused entry by the Examiner and was never considered by him. It therefore appears that the record provides ample basis for the Commissioner's finding of inadvertence, accident or mistake.

Appellee has placed reliance on the prior decisions of this Court in *Riley v. Broadway Hale Stores, Inc.* (1954), 217 F. 2d 530, and *Lockwood v. Langendorf United Bakeries, Inc.* (1963), 324 F. 2d 82. Both of those cases are easily distinguished, however, on the

basis that the applicant sought to cover a different invention in the reissue from that which had been disclosed in the original patent. Such is not the case here, but rather, the subject matter of claims 7 to 10 of the original patent has simply been restated in clearer and better language.

Furthermore, Claims 11-16 are all narrower than any of the claims of the original patent by virtue of the inclusion of the last phrase of Claim 11 which reads:

> "said first and second valves and said hollow body together defining a compartment whose volume is relatively small compared to the combined volume of said air supply and air discharge tubes".

[Ex. 17, Col. 13, lines 46-49]. The materiality of that limitation is explained in the patent [Ex. 17, Col. 9, lines 16-42] and was substantiated by the testimony [Tr. p. 43, lines 4-21; Tr. p. 142, line 13, to p. 143, line 4; Tr. p. 146, lines 16-23; Tr. p. 147, line 22, to p. 148, line 25; Tr. p. 426, line 17, to p. 427, line 16].

Appellee also attempts to rely upon the case of *Muncie Gear Works Inc. v. Outboard, Marine and Mfg. Co.* (1942), 315 U.S. 759. That case is easily distinguished, however, in that the later presented claims covered a different invention than was covered in the original claims. That distinction was recognized in the case of *Hartzell v. McCauley* (CCA 6, 1962), 304 F. 2d 481 at page 484, 134 USPQ 275 at page 278.

Appellee also asserts that new matter has been introduced into the reissue patent in violation of the statute. But at the very same time appellee states, quite correctly, that a scientific explanation cannot be patented (Appellee's Br. p. 22). And it is also well settled law that the mere addition of a theory of operation to a patent application does not constitute new matter in violation of the statute. *Kansas City Southern Ry. Co.*

v. Silica Products Co., 48 F. 2d 503, 506 (CCA 8, 1931), cert. den. 284 U.S. 626, 76 L.Ed. 533 (1931).

The present case involves merely the revision and expansion of a description of theory of operation. Accordingly, the reissue patent was legally obtained.

X.

Validity Is the Primary Issue on This Appeal.

The action of the District Court in reversing its original ruling holding the patent valid, without the introduction of new or different evidence bearing on that question, demands a thorough review by this Court. This Court may hold as a matter of law that the patent is both valid and infringed. *National Sponge v. Rubber Corp.* (CCA 9, 1961), 286 F. 2d 731, 128 USPQ 320 and *Hoeltke v. Kemp,* 80 F. 2d 912, 26 USPQ 114.

The record of this case is replete with evidence and admissions which establish that the apparatus of defendant (appellee) is substantially the same as the apparatus of the Page patented invention and accomplishes the same result in the same manner.

Accordingly, the judgment of the District Court should be reversed, and the patent should be held to be valid and infringed.

Respectfully submitted,

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By GENE W. ARANT,
Attorney for Appellants.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

GENE W. ARANT

No. 20,052

In the

United States Court of Appeals

For the Ninth Circuit

WILLIAM B. GROVER, TRUSTEE IN BANKRUPTCY OF THE ESTATE OF NORTH STATE GROCERS, INC., a corporation, Bankrupt,
Appellant,

vs.

JAMES HULL and AILEEN HULL,
Appellees.

Appellant's Reply Brief

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No. 20052

In the

United States Court of Appeals

For the Ninth Circuit

WILLIAM B. GROVER, TRUSTEE IN BANKRUPTCY OF THE ESTATE OF NORTH STATE GROCERS, INC., a corporation, Bankrupt,
Appellant,

vs.

JAMES HULL and AILEEN HULL,
Appellees.

Appellant's Reply Brief

Appellees' Answering Brief concedes that this court, in *Wilshire Oil Company v. Costello,* (9th Cir. 1965) 348 F2d 241, has held that a Notice of Assignment of Accounts Receivable must be signed by the lender to be valid. There is no logical distinction as to a Notice of Inventory Lien and we will not argue the point further. The *Wilshire* decision is squarely in point and holds, correctly we think, that the lender's signature is necessary to the validity of both a Notice of Assignment of Accounts Receivable and of Notice of Inventory Lien.

Their second contention, that a supposed existing lien is not invalidated upon assignment of the security interest

may require answer. As applied to the facts of this case, it is both confusing and without merit.

1. Appellees' contention applies only to the proceeds from the sale of inventory; it does not apply to the proceeds of accounts receivable.

Involved in this appeal are two separate items: (a) the proceeds of accounts receivable, and (b) the proceeds of a sale of inventory on hand at the time of bankruptcy.

Under former Section 3037 of the Civil Code, a Notice of Assignment of Accounts Receivable must have been filed to maintain the priority in the proceeds of any inventory sold which was originally covered by an inventory lien, where such proceeds constitute an account.

> "§ 3037.....
>
> If such proceeds are an account as defined in Chapter 3b of this title, the lenders' rights to the account or accounts as against third persons are governed by the provisions of said Chapter 3b except that the written statement provided for in Section 3031 of this title shall, unless stated therein to the contrary, constitute an assignment in writing to the lender of any account or accounts that may arise from the sale of any of the merchandise designated therein. In order to perfect his rights to such proceeds which are an account as defined in Chapter 3b of this title, as against third persons, the lender shall comply with the provisions of Chapter 3b relative to filing a notice of assignment or of intention to assign an account or accounts, and his rights to such account or accounts and the proceeds thereof shall be inferior to those of any other assignee of such account or accounts who has first filed the notice of assignment or of intention to assign an account or accounts, or a further notice or affidavit filed prior to the expiration of such notice of assignment pursuant to said Chapter 3b, regardless of whether the assignment of such ac-

count or accounts to such other assignee is prior or subsequent to the written statement provided for in Section 3031 or the filing of the notice provided for in Section 3033, or any assignment of such account or accounts to the lender."

The only Notice of Assignment of Accounts Receivable ever filed was the defective notice filed June 19, 1962. Their claim of a prior lien is limited to the original inventory lien and, accordingly, Appellees have no claim to the proceeds of accounts receivable. At best their argument would reach only the proceeds of the inventory sold after bankruptcy.

2. There is no evidence in the record of any valid lien; in fact the evidence is that there was at best an imperfect lien at the time of the "assignment" to Appellees.

Appellees argue that they are entitled to the proceeds of the inventory sale because of the October, 1960, transaction between Farley and Audia and Redding Specialty Products, Inc., and state as a fact that there was an existing valid lien created. There is absolutely nothing in the record to substantiate this contention.

On the contrary, Appellees themselves recognized that there was a substantial question as to the validity of any "existing" lien. In the instrument of assignment dated May 31, 1962, (I Tr. pages 26 to 29) signed by Appellees, it is expressly provided:

"7. The Lenders understand that there may be some question concerning the legality and validity of the inventory lien and the accounts receivable assignment mentioned above and it is expressly agreed herein by and between Audia and Farley and Lenders, and each of them, as follows:

(a) That the transfer and assignment of such inventory lien agreement and assignment of accounts receivable and other instruments is without recourse

to Audia and Farley and that they shall not be responsible for the payment of the obligations secured thereby.

(b) That Audia and Farley make no warranties, express or implied, representations, guarantees, indemnities or promises or agreements whatever concerning the validity of such inventory lien and assignment of accounts receivable and other instruments and the Lenders agree and understand that Audia and Farley are quitclaiming their interest only in such agreements and instruments and assignments and the Lenders hereby waive any claim of any kind whatever as and against Audia and Farley by reason of the failure of Borrower to pay the moneys due from it or by reason of the invalidity, in whole or in part, for any reason of the inventory lien or the assignment of accounts receivable, or any other instruments herein transferred."

Appellant has admitted that a notice of inventory lien was recorded by Farley and Audia. Appellees, however, did not choose to introduce any other evidence of its validity or of the indebtedness secured thereby.

3. The June, 1962, transaction involved a new loan arrangement between Appellees and the bankrupt. At best it was a novation.

The document entitled "Assignment of Inventory Lien, Inventory Lien Agreement and Assignment of Accounts Payable" (I Tr. pages 26-29) signed by all parties, Farley and Audia, Appellees herein and Redding Specialty Products, and through which Appellees claim to have succeeded to Farley and Audia's rights, was not an assignment of debt with its security as Appellees in their brief seem to imply. The agreement provided first that Appellees were "substituted" "in place and stead of Audia and Farley" and the bank agreed to "accept and novate" the Appellees in

their place and stead. (I Tr. page 26. paragraph 1; page 29) Secondly, it provided that the inventory lien, the validity of which appeared to be in question, was transferred to Appellees, but it should be noted that no indebtedness was assigned. Thirdly, the agreement provided that Appellees would discharge the debt of the bankrupt to the Bank of America and secure the release of Farley and Audia from their guaranty of the bankrupt's obligation.

Nothing in the record evidences any debt except the debt to the Bank of America. This debt, we may be sure, could not be and was not transferred by Farley and Audia to Appellees. It is apparent, and the parties so acted at the time in question, that the agreement was a new agreement between Appellees and Redding Specialty Products whereby Appellees undertook to pay Redding Specialty Products' note to the Bank of America and to advance it additional funds which funds were to be secured by a newly created lien. The testimony of James Hull shows that this was in fact the consideration for the agreement, (II Tr. page 24, lines 13-21; page 32 lines 3-6). The inventory lien was thus security for the obligation under the new agreement, not the assignment of a debt from Farley and Audia because no such debt was assigned by them.

The District Court in its Memorandum and Order herein adopted the finding of fact of the Referee with respect to this agreement and characterized the agreement as follows: "This document was signed by all parties and essentially transferred Leo Audia and Ronald L. Farley out so that the agreement was now between Redding Specialty Products, Inc., and James Hull and Aileen Hull." (I Tr. page 40, lines 12-14) The label put on the agreement is not important. Legally it was a new contract between Appellees and Redding Specialty Products, a contract measured by the terms and agreements of the former inventory lien agreement,

but nevertheless a new loan and a new lien. The same effect would have been achieved had Appellees loaned the bankrupt funds to pay off the note to the Bank of America and thereupon secured the newly created debt from the bankrupt with an inventory lien. The document itself appears to add no further efficacy except to the extent that Farley and Audia were relieved of their burden of guaranty and that no new inventory lien agreement need be retyped. At best, and only when and if the Bank of America note was paid, the agreement might be characterized as a novation, that is, the substitution of one creditor for another.*

The alignment, however, of the parties, so far as it appears in the record, does not indicate Farley and Audia were actually creditors of the bankrupt, except to the extent they may have had a contingent right over against the bankrupt if obliged to pay off the Bank of America. The additional advance to the bankrupt of $30,000 made by Appellees was a new transaction. It is clear, therefore, as both the District Court and the Referee agreed (although

*The legal effection of a novation is, of course, an extinguishment of the original obligation which does not revive regardless of a failure to perform the new agreement. *Alexander v. Angel* (1951) 37 C2d 856, 863.

A novation and its effects are defined in *Eckart v. Brown* (1939) 34 CA2d 182, 187, as follows:

> "(1) Novation is the substitution of a new obligation for an existing one and is made (a) by the substitution of a new obligation between the same parties with intent to extinguish the old obligation, (b) by the substitution of a new debtor in place of the former one with intent to release the latter, or (c) by the substitution of a new creditor in place of the former one with intent to transfer the rights of the former creditor to the new creditor. (Sec. 1531, Civ. Code; 46 Cor. Jur., (1928) 573, sec. 1.)
>
> "(2) The effect of a novation is to make the original agreement a nullity (that is, void and of no effect), and the rights of the new parties are governed solely by the new agreement. [citations] *The novation in legal contemplation gives rise to a situation which is the same as if there had never been a former agreement or obligation.*" [Emphasis added]

reaching opposite conclusions on the issue) that the issue in this case is whether or not the notices recorded by Appellees in June of 1962 sufficiently complied with the code to perfect a new inventory lien. Admittedly they did not.

4. The new loan transaction required a notice to be filed signed by the new lender because the prior notice no longer complied with the law.

It is elementary that whatever equitable rights the assignment of the inventory lien from Farley and Audia gave to Appellees, the recorded notice of the lien was not property and could not be assigned. Appellees recognized this and did in fact record the defective notice of inventory lien. They also recorded a similarly defective notice of assignment of accounts receivable which had not been recorded by Farley and Audia.

The District Court herein recognized that upon execution of the agreement in May of 1962, the notice recorded by Farley and Audia no longer complied with the law requiring the notice to be signed by "the lender." (I Tr. page 45 lines 9 to 15). While the provisions of the Civil Code do not specify precisely how and under what circumstances a new or amended notice should be filed, it is clear that where the original notice no longer complied with the law, the protection afforded by the recording laws could be achieved only by recording a new notice which did so comply and which was signed by the lender.

Appellees ignore this fact and to point to the language in Section 3034 ("Amendments of the notice may be filed") claiming that such amendments are permissive. This is a fictitious issue. The sentence in Section 3034 which refers to amendments of notices read as follows: "Amendments of the notice may be filed from time to time in the same manner to record any changes in the information contained

in the original, subsequent or amended notices." As this court pointed out in *Wilshire,* the word "may" used in a statute can actually be mandatory, as in this case it was patently so. The Farley-Audia notice no longer complied with the requirement that the notice be signed by the lender. Without a new or amended notice, there was literally and simply no notice of record which fulfilled the requirements of Section 3032. There is no greater weight to Appellees' argument that a "valid" inventory lien cannot be lost by failure to re-record upon assignment than there is to suggest the lien cannot be lost if, for example, the merchandise were changed to an address different from the one stated on the original notice. The statute obviously contemplated that in the case of such a "floating lien" that the lender's rights could and were subject to loss by circumstances which might be beyond the lender's control.

The amendment provided for in Section 3034 refers to "changes in information". This clearly means the information required to be given in the original notice—namely, the names and addresses of the lender and borrower, the maximum amount of indebtedness to be secured, the type of merchandise subject to the lien and the address at which such merchandise is located. The suggestion of permissiveness from the statutory language thus would rather indicate that the lender "may" or "might" record such amendments, but that he must do so if he wished to protect himself.

In the same connotation and with respect to the change of the name of the borrower from "Redding Specialty Products, Inc.," to "North State Grocers, Inc." the District Court, by its holding that the inventory lien would not be binding on subsequent creditors who did not know of the change of name, clearly assumed that an amendment of the notice would have to be filed to validate the lien despite the

"permissive" language of the sentence quoted above. Appellees' argument, therefore, that "amendments" are merely permissive is wrong. In any event it cannot be used to supply a deficiency, namely, that in this case the original notice upon which Appellees now rely, was not in fact signed by the actual lender. It no longer complied with Section 3032.

Both the District Court and the Referee recognized the true issue in this case, is that the statute required the signature of the lender and that there was literally and simply no recorded notice signed by the lenders who by their own testimony and documents are the Appellees. Under these circumstances it is clear that a notice signed by the lenders must be recorded to validate the lien. This Appellees did not do.

CONCLUSION

Appellees concede in effect that their rights to the accounts receivable or their proceeds must fall under the decision of this court in *Wilshire.*

As to their claim to the proceeds of the inventory sale, the evidence shows a new agreement was entered into by them and by the bankrupt for which an inventory lien was to be security. Their failure to sign a notice, as well as their subsequent failure to record a notice when the bankrupt changed its name, invalidates the claimed lien as against the trustee in bankruptcy, Appellant herein.

Appellant respectfully submits that the order of the District Court insofar as it declared Appellees' liens as valid prior to the name change should be reversed.

Dated: December 17, 1965. San Francisco, California.

Milton Maxwell Newmark,
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By E. M. Mannon
Attorneys for Appellant.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

E. M. MANNON

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

COZZIE MERRILL JONES, Appellant, —vs— FRANK A. EYMAN, Superintendent of the Arizona State Penitentiary, Appellee.	NO. 20054

PETITION FOR REHEARING

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CLERK OF THE U. S. CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

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IN THE

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FOR THE NINTH CIRCUIT

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CLERK OF THE U. S. CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR REHEARING

Appellee herein, FRANK A. EYMAN, Superintendent of the Arizona State Penitentiary, by and through the Attorney General of the State of Arizona, DARRELL F. SMITH, and the County Attorney of Pinal County, State of Arizona, E. D. McBRYDE, respectfully petition this honorable Court to grant a rehearing in the above entitled case, and as grounds therefore, respectfully set forth as follows:

I.

That the corpus of the opinion as rendered by this Court in the above entitled case on November 24, 1965, contains recitations of fact, presumably as predicate for the decision which are not supported by the record, and, in at least one instance, is contradicted by the record. The erroneous assertions of fact are as follows:

(a) ASSERTION — That appellant requested the aid of an attorney at the time a confession was given by him on December 8, 1962, at 4:00 o'clock a.m.

RECORD — The confession referred to is not a part of the record of the above entitled case, nor is reference made to it therein other than through argument of counsel and a brief reference in testimony at the District Court level. There is no indication in the record that a request was made by Jones for an attorney at that time, and as a matter of fact, the only discussion concerning an attorney occurred when appellant indicated that he would rather wait to give a statement until after he had acquired counsel.

(b) ASSERTION — That Jones again requested counsel when he gave a second confession on December 11, 1962.

RECORD — The confession referred to is set forth verbatim in the transcript of the preliminary hearing, pages 109 through 137. No request was made therein for counsel.

(c) ASSERTION — That appellant requested counsel at his preliminary hearing on December 14 and 18, 1962.

RECORD — It is correct to state that appellant complained of lack of counsel at the preliminary hearing; however, at no point in the record did he ever request counsel.

(d) ASSERTION — That appellant had no knowledge of his right to obtain counsel at the Superior Court level.

RECORD — There is nothing in the record indicating that appellant lacked knowledge of the Arizona practice of appointing counsel at the Superior Court level, or that he did not know that it would be possible to have the matter remanded to the Justice of the Peace for a second preliminary hearing after appointment of counsel. The record affirmatively reflects that appellant was aware of his right to have counsel appointed at his arraignment in Superior Court. At page 50, lines 13 through 17 of the preliminary hearing transcript, appellant states in response to a question from the Court:

> "Yes, I have had the chance, the opportunity. (To consult with counsel). But I haven't been able to get any for financial reasons. I understand the Court will — *in Superior Court that they will appoint somebody.*" (Emphasis supplied).

(e) ASSERTION — That the trial judge expressed concern about appellant's mental condition.

RECORD — The only statements of the trial judge contained in the record were at best ambiguous and were subject to the interpretation that he was inquiring concerning appellant's physical appearance, rather than his mental condition.

II.

The holding of this Court does not make clear what "circumstances" disclosed by the record led them to conclude that appellant's constitutional rights were infringed. The State of Arizona, therefore, has no way of determining whether the decision is based upon the circumstances cited previously in the decision, some of which are not borne out by the record, or whether other facts in the case were considered controlling.

III.

In view of the vagueness and ambiguity referred to in No. II. above, counsel for appellee and the State of Arizona are left completely ignorant of (1) what errors of commission or omission are responsible for the Court's conclusion that appellant's Constitutional Rights have been violated, and (2) which of the ten clauses contained in the sixth and fourteenth amendments to the United States Constitution were "offended." Certainly, the State of Arizona is not entitled to a favorable decision as a matter of right; but, it is respectfully submitted that if the State of Arizona, its judiciary, and enforcement officers are to avoid making further errors which might result in the loss of a defendant's constitutional rights, they are then entitled to receive from this Court a clear and definite enunciation of the precise facts and law upon which this Court's ruling is based.

IV.

In spite of the Court's assertion to the contrary, the terms of the alternative to discharge, as set forth in the decision, leads to the inevitable implication that this Court is holding that the trial judge abused his discretion in refusing to allow appellant to withdraw his plea of Guilty. Such a holding would be contrary to the previous decisions of the Court of Appeals for the Ninth Circuit and of the United States Supreme Court. *(Machibroda vs. U.S.,* 368 U.S. 487, 82 S.Ct. 510). This issue presents no federal question and therefore the decision of the State of Arizona is necessarily controlling. (*State vs. Jones,* 385 P.2d 1019, 95 Ariz. 4.)

Finally, may it be submitted into the record before this Court that a perusal of the documents, transcripts and records on file herein would indicate that the entire proceedings with reference to Cozzie Merrill Jones since his incarceration on December 8, 1962, are marked throughout by the fact that all the parties concerned with, or connected to, the case have met their responsibilities with singular dedication of purpose. Two private citizens, when they discovered that a young child was about to be molested,

risked their property and their lives in an effort to apprehend Cozzie Jones. Carl Quast, the victim, met his responsibilities when he avoided violent contact with the defendant in the presence of his (the victim's) mother-in-law, and left his home at gun point, silently, thereby avoiding any risk of injury to the old lady, and also thereby sealing his own doom. Two peace officers arrested the defendant at night under circumstances which make it clear that they treated the defendant politely and with due respect for his rights, even though they had been informed that he was armed and dangerous. William Craig Haus met his responsibilities when he took upon himself the burden of allowing his client to plead Guilty to a capital offense, even though this was done contrary to his best advice. He could very easily have avoided this duty by withdrawing as defendant's counsel, but as is stated elsewhere in the record, if Cozzie Merrill Jones had continued in his determination to plead Guilty, some lawyer, somewhere, sometime, would have been forced to bear the responsibility that Mr. Haus could have avoided. The Superior Court Judge, the Honorable T. J. Mahoney, met his responsibilities when he refused to allow withdrawal of the plea of Guilty at a time when the record indicated no justification whatever for such a withdrawal. His judgment and fidelity to the law of the State of Arizona were vindicated by the five members of the Arizona Supreme Court. (*State vs. Jones,* 385 P.2 1019, 95 Ariz. 4). Judge Muecke of the United States District Court for the District of Arizona met his responsibility in recording a detailed findings of fact and conclusions of law after hearing the testimony involved in the present appeal. If any or all of these people have committed error so grievous that a human being's constitutional rights have been violated, the innocent ones, at least, are entitled to the benefit of a decision from this Court which will meet the responsibility that is borne by all members of the Federal and State Judiciary, to the end that the law applicable to this case shall be made clear and the facts defined.

For the above reasons and grounds, appellee respectfully petitions this honorable Court to grant a rehearing in the above entitled cause, pursuant to the provisions of the rules of the Ninth

Circuit Court of Appeals, Number 23. It is further respectfully suggested that this Court as presently constituted request of the Chief Judge of the United States Court of Appeals, Ninth Circuit, that the rehearing be held en banc.

Respectfully submitted,

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Attorney General
State of Arizona
Phoenix, Arizona

By
Assistant Attorney General

E. D. McBRYDE
Pinal County Attorney
Florence, Arizona

By
Chief Deputy County Attorney

CERTIFICATE OF COUNSEL FOR APPELLEE

Comes now Lloyd D. Brumage, Chief Deputy County Attorney, Pinal County, State of Arizona, and hereby certifies to the United States Court of Appeals for the Ninth Circuit, that in his judgment, the attached petition for rehearing in the above entitled case is well founded, and further certifies that it is not interposed for delay.

Lloyd D. Brumage

Lloyd D. Brumage
Chief Deputy County Attorney
Pinal County

AFFIDAVIT

Comes now Lloyd D. Brumage, he being first duly sworn upon his oath, deposes and says:

That he is the Chief Deputy County Attorney of the County of Pinal, State of Arizona.

That on the 10 day of December, 1965, at 11:00 A.M. o'clock, he served appellant's counsel with copies of the Motion for Rehearing by deposit of three copies to each attorney, First Class, into the U. S. Mails at the Post Office of the United States, located at Florence, Arizona. The names and addresses of the counsels for the appellant who have been served are:

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Attorney at Law
3033 North Central Avenue
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Tucson, Arizona

Attorneys for the appellant.

Lloyd D. Brumage

Lloyd D. Brumage
Chief Deputy County Attorney
Pinal County

SUBSCRIBED AND SWORN to before me this 10 day of December, 19 65.

Diane Whitlow

Notary Public

My Commission expires:

November 2, 1969

NO. 20066

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MICHAEL RIZZO,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

FILED

NOV 1 1966

WM. B. LUCK, CLERK

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APPELLEE'S BRIEF

I

JURISDICTIONAL STATEMENT

On March 18, 1964, a one-count indictment was returned against appellant by the Federal Grand Jury for the Southern District of California, Central Division [C. T. 2-3]. 1/

The indictment charged appellant with wilfully failing to file an income tax return for the year 1957 in violation of Title 26, United States Code, Section 7203.

Appellant was convicted by a jury on January 13, 1965 [C. T. 17], and on January 29, 1956 was sentenced to four months

1/ C. T. refers to Clerk's Transcript.

in a jail type institution and a $1,000 fine [C. T. 18].

Appellant filed a timely notice of appeal and was granted leave to appeal in forma pauperis by the District Court Judge [C. T. 20, 25].

The jurisdiction of the District Court was predicated on Title 18, United States Code, Section 3231 and Title 26, United States Code, Section 7203. This Court has jurisdiction to entertain this appeal under the provisions of Title 28, United States Code, Sections 1291 and 1294.

II

STATUTES INVOLVED

Title 26, United States Code, Section 7203 provides:

> "Any person required under this title to pay any estimated tax or tax, or required by this title or by regulations made under authority thereof to make a return (other than a return required under authority of section 6015 or section 6016), keep any records, or supply any information, who willfully fails to pay such estimated tax or tax, make such return, keep such records, or supply such information, at the time or times required by law or regulations, shall, in addition to other penalties provided by law, be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than

$10,000, or imprisoned not more than 1 year, or both, together with the costs of prosecution."

III

STATEMENT OF THE CASE

Appellant was indicted on March 18, 1964 on the charge of willfully failing to file an income tax return for the calendar year 1957 in violation of Title 26, United States Code, Section 7203 [C. T. 2].

Appellant was arraigned and entered a plea of not guilty on April 13, 1964 [C. T. 4].

Trial by jury commenced on January 12, 1965 before the Honorable John F. Kilkenny, United States District Judge [C. T. 6].

On January 13, 1965, appellant was found guilty by the jury and on January 29, 1965, he was sentenced to four months imprisonment and a fine of $1,000.00 [C. T. 17, 18].

IV

STATEMENT OF FACTS

A. EVIDENCE OF GUILT

The Government and appellant stipulated that appellant had in excess of $600 gross income in 1957 and that at the time of trial

he was 56 years of age [R. T. 59, 183]. 2/

An investigation by the Internal Revenue Service began in 1956 into the matter of appellant's failure to file income tax returns for the calendar years 1950 through 1955 [R. T. 91]. In July of 1956 appellant admitted that he was aware that he must file a return if he has in excess of $600 of gross income [R. T. 92]. Later that year he agreed that he had approximately $3500 of income each of those years and to the amount of tax owing, although he did not file returns for any of those years [R. T. 115, 125, 118].

At the same time that appellant agreed that he had income for those years, the Revenue Agent advised him to file a 1956 return in April of 1957 [R. T. 116]. None was filed [R. T. 88].

In early 1958 another agent talked to appellant regarding collection of appellant's delinquent taxes and requested appellant to file his 1957 return with the Agent [R. T. 75-76]. Appellant did not file a return with the agent or in the district where he resided [R. T. 77, 87].

In a 1963 interview with still another agent appellant stated that he filed a 1957 California State Income tax return [R. T. 104]. No such return was filed [R. T. 111].

Appellant's accountant testified that he had been preparing appellant's tax returns from 1954 through 1962 [R. T. 136]. However, when he gave appellant his 1954 and 1955 returns, appellant tore them up and stated that he did not have any income, only loans,

2/ R. T. refers to Reporter's Transcript.

although appellant later agreed with an Internal Revenue Agent that he had approximately $3,500.00 income in each of those years [R. T. 142, 151, 115].

The accountant did testify that he had a copy of a 1957 return in his file, but that he did not know if it was mailed or when it was typed [R. T. 136, 146, 148]. Moreover, it was the accountant's practice, if a tax were owed to give the return to the taxpayer, with an envelope for mailing [R. T. 147, 137].

The accountant's copy of appellant's 1957 return shows that $575.38 was due [Exhibit #1].

B. PRODUCTION OF FILES AND STATEMENTS. [3]

Prior to the trial Government Counsel lodged with the Court all witnesses' statements that if believed, should be produced under Title 18, United States Code, Section 3500, and all other available witnesses' statements for an in camera determination [R. T. 40]. The Court then ordered all of the statements furnished to the defendant [R. T. 55].

3/ Appellant suggests in the first paragraph of page 20 of his brief that the Government withheld certain documents seized from appellant or furnished by his accountant. The Court on November 30, 1964, ordered the Government to lodge all such documents a few weeks prior to trial [3rd Supplemental Transcript, p. 16]. The Government did lodge all such documents which it claimed it had in its possession [R. T. 47]. There was no testimony or offer of proof from the appellant that the Government had obtained documents which were withheld.

The only witness upon whom a demand was made for notes of an interview with appellant was ex-Internal Revenue Agent Hyman Kosman [4/] who testified to appellant's admissions as to income during the years 1950 through 1955 and his advice to appellant to file a 1956 return, which took place in the later part of 1956 or early part of 1957 [R. T. 113-116, 129].

At the time of this demand Government counsel represented that the agent's notes and report had been destroyed but that a copy of his report was in appellant's accountant's files which had been lodged with the Court [R. T. 129-130].

The Chief of the Audit Division then testified, in the absence of the jury, that he made a search of his records and found no records concerning appellant [R. T. 132].

Following the verdict the Court held a special hearing to determine whether the notes qualified as statements within the meaning of the act and if so whether they were destroyed in good faith [R. T. 235-273].

At this hearing the Chief of the Audit Division testified that his Division makes between fifty-five to sixty thousand audits each year [R. T. 237]. He further testified that within six years after a Revenue Agent has submitted a report, the entire file is destroyed pursuant to regulations of the Internal Revenue Service [R. T. 236]. The copy of Agent Kosman's report taken from the accountant's files was prepared on March 6, 1957 and mailed on June 18, 1957

4/ The transcript incorrectly spells the agent's name Cosman.

[R. T. 250-251] and that all such reports would have been destroyed [R. T. 251].

Mr. Kosman testified that he did not use his notes in preparing the report or make any statement from them [R. T. 254]. He also testified that once he sends in his report and it is approved, the investigation is closed. It is then placed in the closed files [R. T. 258]. Mr. Kosman was only involved in the years 1950 through 1955 [R. T. 255].

At a later time Mr. Kosman testified that he would not make substantially verbatim notes of the conversation but only sketchy notes from which he could determine appellant's living expenses for the years in question [R. T. 267-268].

Later that day the Court found that the notes were not a statement within the meaning of the act and that they had been destroyed in good faith [Order dated January 14, 1965].

V.

ARGUMENT

A. THE EVIDENCE WAS SUFFICIENT TO SUSTAIN THE CONVICTION.

Appellant now, for the first time on appeal, questions the sufficiency of the evidence. 5/

5/ At the trial no motion for judgment of acquittal was made either at the close of the Government's case in chief or at the close of all the evidence. This Circuit has repeatedly held that the failure to make such a motion precludes an attack upon the (continued)

The Government fully concedes that to establish wilfulness, more must be shown than that the defendant was careless, inadvertent, or in good faith believed that he did not have to file a return. United States v. Murdock, 290 U.S. 389 (1933).

"Wilfulness" as used in the misdemeanor statute here involved has been defined on several occasions by this Circuit to have a different and lesser meaning than when used in a felony statute.

> "In the definition given, the trial court began with the statement that 'wilful' as used in the misdemeanor counts means with a bad purpose, which standing alone would meet appellant's criticism, but it is argued that the addition of the words 'or without grounds for believing that one's act is lawful or without reasonable cause, or capriciously, or with a careless disregard whether one has the right so to act,' so watered down the meaning of the term 'with a bad purpose' as to render the instruction erroneous. We conclude that the word 'wilful' as used in the misdemeanor statute means something less when applied to a failure to make a return than as applied to a felony non-payment of a tax. This being true, then the words used in the instruction defining 'wilful' as

5/ (continued) sufficiency of the evidence on appeal. Hardwick v. United States, 296 F.2d 24 (9th Cir. 1961); Ege v. United States, 242 F.2d 879 (9th Cir. 1957); Joseph v. United States, 145 F.2d 73 (9th Cir. 1944), cert. den. 323 U.S. 776.

relates to a misdemeanor adequately and clearly point up that difference."

Abdul v. United States, 254 F.2d 292 (9th Cir. 1958), cert. den. 364 U.S. 832.

While, as appellant points out in his brief, Abdul, supra, was reversed, the reversal was solely on the grounds that Government counsel was permitted to ask an improper question.

In a subsequent case, Martin v. United States, 317 F.2d 753 (9th Cir. 1963), this Court rejected an attack upon the sufficiency of the evidence where the defendant claimed that he didn't think he had to file a return in view of his meager income. There the evidence showed that the defendant was a college graduate and had received withholding statements from his employer and statements from a brokerage firm with instructions that they be retained for income tax purposes. This Court, in affirming the conviction, stated at 317 F.2d 755:

> "Assuming for the moment that appellant was in fact unaware of the exact amount of income one must have before reporting is required, we can only wonder why in light of these warning signs he made no effort to find out. We conclude that the evidence was sufficient to establish that he did not have reasonable cause for believing he was not subject to the reporting requirements and acted with a careless disregard of whether he was subject to those requirements."

The Court also restated the rule of Abdul, supra, at 317 F.2d 754:

> "In this regard, 'willful' for the purpose of 7203 means 'with bad purpose or without grounds for believing that one's act is lawful or without reasonable cause or capriciously or with a careless disregard whether one has the right so to act."

In the instant case appellant was in contact with Internal Revenue agents for almost three years prior to April 1958 during which time he admitted he knew the requirements, was told to file for 1956 and was told to file for 1957 and yet, according to the evidence, never filed a single federal income tax return for the years 1950 through 1957. Moreover, he tore up his returns for 1954 and 1955 and later admitted that he had over $600 income in each of those years as well as the prior years. 6/

Edwards v. United States, 321 F.2d 324 (5th Cir. 1963), relied upon by appellant reversed in a two to one decision, a conviction under this statute for failure to pay the special wagering tax on the ground that there was no evidence that the defendant was in any way aware of such an obligation. The court did suggest

6/ In reviewing the sufficiency, the evidence should be viewed in the light most favorable to the Government.

Schino v. United States, 209 F.2d 67 (9th Cir. 1954);

Glasser v. United States, 315 U.S. 60 (1941).

that proof of knowledge of the obligation to file may not even be necessary in an income tax case under this section. 7/

With respect to the proof of the actual failure to file, the accountant testified that he normally would have given the return to the taxpayer for mailing if a tax was due, as his copy of the return indicated. Moreover, when viewed in the context of appellant's prior conduct, the negative search would seem conclusive. In this regard, one considers how a failure to file could ever be proved without an admission were it not for a negative search. Counsel cites no case which suggests that a negative search of official records is an improper or inadequate method of proving that something didn't happen.

B. THE COURT DID NOT ERR IN FAILING TO STRIKE THE TESTIMONY OF THE WITNESS KOSMAN NOR IN NOT DECLARING A MISTRIAL.

The evidence produced both at trial and at the special hearing was sufficient to establish that Kosman's notes were destroyed in good faith. There was evidence that Kosman was a Revenue

7/ "We may assume, without deciding, that in cases involving nonpayment of income tax (citations) the almost universal knowledge of the existence of that tax would justify placing the initial burden of proof of ignorance on the defendant." 321 F.2d 324, 326.

An earlier case from the Fifth Circuit, relied upon by appellant specifically, rejected this Circuit's construction of the term willfull in 7203. Haner v. United States, 315 F.2d 792 (5th Cir. 1963).

Agent, concerned only with the assessment of appellant's taxes for the years 1950 to 1955, he was not concerned with any year after; he was not conducting a criminal investigation; he finished his dealings with appellant and made his report in March of 1957; in the normal course of operation of the Internal Revenue Service, the Revenue Agent's report would have been destroyed in 1963; and appellant was not indicted until March, 1964. Moreover, appellant does not here assert that the notes were destroyed in bad faith.

Appellant contends that good faith is not enough, and that the testimony of a witness must be forever barred if, for legitimate reason, his notes or a report based upon them, are not available. He argues that Ogden v. United States, 323 F.2d 818 (9th Cir. 1963) and Killian v. United States, 368 U.S. 231 (1961), are distinguishable on the grounds that reports based upon the notes were available.

Appellant quotes the following from Ogden, supra, to establish that the issue here is unresolved:

> "Whether sanctions are to be imposed if a producible statement has been destroyed in good faith and the information in the destroyed document relevant for impeachment is not otherwise available, and whether sanctions are to be imposed without regard to prejudice if destruction is in bad faith may remain open issues. . . ."
>
> 323 F.2d 818, 820-821.

However, in the footnote to this statement, 8/ this Circuit recognized that the First Circuit has held and the Second Circuit indicated that such situations do not give rise to sanctions. In Campbell v. United States, 303 F.2d 747 (1st Cir. 1962), cited in this footnote, the Court, on rehearing stated:

> "In our opinion of November 7, 1961, 296 F.2d 527, we said that the Jencks Act imposed no duty on the agents of the FBI to take the statements of witnesses and no duty, at least in the absence of bad faith, to keep any statements that might have been taken. Therefore, there being no evidence from which it could possibly be found that Toomey destroyed his notes in bad faith, the question propounded by this petition for rehearing whether his notes, had they not been destroyed, would be producible under Section (e)(1) of the Act is academic."
>
> 303 F.2d 747, 751.

In the second case referred to in the footnote, United States v. Aviles, 197 F. Supp. 536 (S.D. N.Y. 1961) Judge Bicks stated

8/ "As noted above, the Court of Appeals for the First Circuit indicated in its second Campbell opinion (296 F.2d 527, at 531-534) and held in its third (on petition for rehearing, 303 F.2d at 751) that sanctions do not apply in these circumstances. The Court of Appeals for the Second Circuit has indicated, though not held, that it agrees. See, e.g., United States v. Aviles, 315 F.2d 186, 188 (2d Cir. 1963), adopting opinion of Judge Bicks at 197 F. Supp. 536, 553-558 (S.D. N.Y. 1961); United States v. Greco, 298 F.2d 247, 250 (2d Cir. 1962)." 323 F.2d 813, 821.

at 197 F. Supp. 555 yo 556:

"Petitioners contend that the government's failure to have produced or satisfactorily accounted for these notes constitutes a Jencks Act violation sufficient to entitle them to a new trial. It will be noted that in the recent case of Campbell v. United States, 1961, 365 U.S. 85, 81 S. Ct. 421, 5 L. Ed. 2d 428, the Supreme Court left open the question as to whether destruction for improper motives or in bad faith should be regarded as the equivalent of non-compliance with an order to produce or whether any destruction without regard to the circumstances should be so regarded. § 3500, by its very terms, refers to a 'statement * * * of the witness in the possession of the United States.' In the Court's view, it was not the intention of the Congress in enacting § 3500 to require the government to retain in its files ad infinitum, with penalizing consequences for the failure so to do, the numerous notes taken during untold interviews in connection with the investigation of countless criminal matters (citation). This is not to state or imply that the government may with impunity and for improper ends destroy notes in an attempt to deprive criminal defendants of that which the Congress has seen fit to grant them. The Court holds that the good faith destruction of notes not within

the ambit of the Jencks statute is not the equivalent of non-compliance with an order to produce."

It should be noted that in the instant case Agent Kosman was not even engaged in a criminal investigation and was in no way involved in the investigation for the year out of which this charge arose.

VI.

CONCLUSION

For the reasons herein stated the judgment should be affirmed.

Respectfully submitted,

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ROBERT L. BROSIO,
Assistant United States Attorney,
Chief, Criminal Division,

ARTHUR I. BERMAN,
Assistant United States Attorney,

Attorneys for Appellee,
United States of America.

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Arthur I. Berman

ARTHUR I. BERMAN